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RECENT DEVELOPMENTS RELATED TO TRANSNATIONAL CORPORATIONS AND INTERNATIONAL ECONOMIC RELATIONS

Home country incentives for investment in least developed countries

Report of the Secretary-General

SUMMARY

The present report briefly describes the measures adopted by home countries and multilateral institutions for encouraging transnational corporations to invest in least developed countries.

Home countries offer a variety of assistance to least developed countries through the mechanisms of official financial and technical assistance, which might indirectly encourage transnational corporations to invest. They have also adopted a number of measures directly relevant to transnational corporations; but most of these are designed to encourage investment in developing countries and do not focus specifically upon least developed countries.

Home country measures are diverse and usually take the form of tax incentives, financial support administered by public development finance corporations or other institutions, promotional activities, dissemination of information, efforts to improve protection of investment and returns thereto and preferential access to exports. A number of multilateral and regional institutions have also put in similar measures.

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The fact that most of the measures are not specifically aimed at the least developed countries, and the limited availability of information on the extent to which those countries have actually availed themselves of existing benefits, does not at this time permit an assessment to form the basis of policy recommendations for further actions.

Nevertheless, the report identifies certain areas where measures could be adopted with particular focus on investment in least developed countries. Among these are the removal of obstacles to outward investment, unilateral fiscal concessions, earmarking for the least developed countries a proportion of financial resources to support foreign investment and further liberalization of trade measures in favour of least developed countries.

The report concludes by noting that in view of the many constraints faced by least developed countries in attracting transnational corporations, concerted action is required by all parties - home countries, multilateral institutions and least developed countries themselves - on a number of fronts simultaneously.

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INTRODUCTION

1. At its fifteenth session, the Commission on Transnational Corporations adopted a resolution which, inter alia, requested the Secretary-General to undertake a study on home-country legislation on investment by transnational corporations in the least developed countries. 1/ The present report is in response to that request.

2. A number of observations concerning the present report deserve to be highlighted. Preliminary research indicates that home countries for the most part do not have legislative or other measures aimed specifically at encouraging foreign investment by their transnational corporations in least developed countries. They do, however, have programmes to facilitate foreign investment by their firms in developing countries in general. Consequently, the report can examine and summarize only measures related to developing countries in general. Table 1 presents a summary of those measures.

3. It should be emphasized that the report essentially enumerates the kind of measures that are in force in home countries to encourage their transnational corporations to invest in developing countries generally. Very little information is available on the effectiveness of the measures or the resources made available for their implementation. For instance, if a financial facility is put in place in a home country to support investment abroad, its impact on actual investment flows to least developed countries would depend, among other factors, on which countries are eligible; what conditions govern home country enterprises' access to the facility; and the amount of resources available for the facility. A probe into the effectiveness of particular measures would thus require considerably more detailed research than was feasible in the course of the present exercise. The description of the measures contained in the report should, therefore, be viewed as indicative of the qualitative nature of actions taken by home countries; no conclusion should be drawn regarding their quantitative significance.

4. The report also covers measures taken by multilateral organizations that can facilitate investment in developing countries, although the emphasis is on home country programmes. The inclusion of measures by multilateral organizations is warranted by the fact that bilateral and multilateral measures often interact and support each other in encouraging investment, both domestic and foreign, in developing countries. Furthermore, the report indicates some areas where home countries could adopt supportive actions especially focused on least developed countries.

Table 1. Promotional measures by developed countries to encourage foreign investment in developing countries

Country	Fiscal measures	Development finance institution	Other official support	Bilateral investment treaties	Investment guarantee schemes
Australia	Tax treaties	Yes	Yes	No	Yes
Austria	Tax treaties	No	Yes	Yes	Yes
Belgium	Tax treaties	Yes	Yes	Yes	Yes
Canada	Tax treaties	No	No	Yes	Yes
Denmark	Tax treaties	Yes	No	Yes	Yes
Finland	Tax treaties	Yes	No	Yes	Yes
France	Tax treaties	..	..	Yes	..
Federal Republic of Germany	Tax treaties	Yes	Yes	Yes	Yes
Italy	Tax treaties	No	Yes	Yes	Yes
Japan	Tax treaties	Yes	Yes	Yes	Yes
Netherlands	Tax treaties	Yes	Yes	Yes	Yes
New Zealand	Tax treaties	No	Yes	No	Yes
Norway	Tax treaties	No	Yes	Yes	No
Sweden	Tax treaties	Yes	No	Yes	Yes
Switzerland	Tax treaties	No	No	Yes	Yes
United Kingdom	Tax treaties	Yes	Yes	Yes	Yes
United States	Tax treaties	Yes	Yes	Yes	Yes

Sources: OECD, "Development co-operation for private sector development including foreign direct investment: a compendium of measures", (Paris, OECD, 1988), mimeo.; Bilateral Investment Treaties (United Nations publication, Sales No. E.88.II.A.1); and International Tax Treaties of All Nations: Cumulative Index (Dobbs Ferry, Oceana Publication, 1983).

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5. It should be recalled that the role of transnational corporations in the least developed countries is limited. Foreign direct investment inflows from transnational corporations in these countries ranged from a negative figure to a few million dollars, and their share in total flows to all developing countries remained below two per cent (see table 2). Among the reasons for such small flows are that these countries often do not have the economic conditions, physical infrastructure, human resources, geographic location or the political stability that would be conducive to investment, either domestic or foreign. These constraints, which were dealt with at some length in a report of the Secretary-General on the role of transnational corporations in the least developed countries submitted to the Commission last year, may be briefly recalled. 2/ For domestic market-oriented production, transnational corporations seek to invest in countries where there is a large market with a substantial domestic demand. In most least developed countries, however, the domestic markets are too small; and in a few cases where the population size is large, the income level is very low. The per capita gross domestic product (GDP) of a typical least developed country is between $150 and $200. 3/ Insufficient physical infrastracture, such as transportation, power supply, telecommunications, water supply and waste disposal, discourages investment for the production of export goods. The poor state of human resources development is reflected in low literacy and a severe dearth of local entrepreneurial capability, managerial expertise or technical skills, which are of vital importance for foreign investment, particularly in manufactures and services. The geography of the least developed countries is often an inhibiting factor for foreign investment. Most of these countries are either land-locked or island economies. And least developed countries often experience political instability. In the light of their past role and in the presence of so many constraints, transnational corporations cannot realistically be expected to make a large contribution to meeting the development challenge in least developed countries in the immediate future. They can, nevertheless, play an important catalytic role, and attention should be paid to creating conditions conducive to such a role.

6. To create such conditions by way of mitigating some of the adverse factors, noted above, least developed countries require both financial and technical assistance from donor countries and multilateral organizations in many areas such as strengthening the private enterprise sector, including small and medium enterprises, and developing the physical and financial infrastructure in these countries. It can also include assistance to encourage and support economic policy adjustments designed to induce private investment; stimulate productive enterprise operations; facilitate economically sound exports; design selective and phased deregulation or improvements in governmental interventions in business; reform commercial and accounting laws and investment codes; rationalize the parastatal sector and formulate appropriate fiscal, exchange rate and trade policies. Least developed countries do receive financial and technical assistance in many of these areas from multilateral organizations and/or donor countries on a bilateral basis. However, the present report focuses on measures more directly relevant to investment by transnational corporations.

Table 2. Inflows of foreign direct investment to least developed countries, 1980-1988

(Millions of United States dollars)

Country	1980	1985	1986	1987	1988
Afghanistan	9.0	..	..	..	..
Bangladesh	..	..	2.5	3.2	1.9
Benin	4.3	..	1.0	..	..
Bhutan	..	..	..	..	..
Botswana	111.5	53.6	70.4	113.5	39.9
Burkina Faso	..	-1.4	..	..	..
Burundi	..	0.5	1.5	1.4	1.2
Cape Verde Islands	..	..	..	..	..
Central African Republic	5.3	2.9	8.2	11.9	11.9
Chad	..	53.6	28.2	8.1	8.1
Comoros	..	..	..	..	7.6
Djibouti	..	..	1.0	..	..
Equatorial Guinea	..	2.0	6.0	2.0	1.0
Ethiopia	1.0	..	-1.0	-3.0	-0.1
Gambia	..	..	..	6.8	11.0
Guinea	1.0	1.0	4.0	6.0	5.0
Guinea-Bissau	..	1.0	1.0	..	1.0
Haiti	13.0	5.0	4.9	4.8	10.2
Kiribati	..	..	..	..	..
Lao People's Democratic Republic	..	-2.0	..	..	..
Lesotho	..	..	..	..	..
Malawi	9.5	0.5	..	..	..
Maldives	..	1.0	-1.0	..	..
Mali	2.3	2.8	-8.3	-5.9	0.7
Mauritania	27.1	7.0	4.5	1.7	1.7
Mozambique	4.4	0.3	..	..	..
Myanmar	0.4	..	-2.0	..	..
Nepal	0.3	1.0	1.0	1.0	1.0

Table 2 (continued)

Country	1980	1985	1986	1987	1988
Niger	49.1	-9.3	..	..	..
Rwanda	16.4	14.6	17.6	17.6	21.1
Sao Tome and Principe	..	..	..	..	..
Sierra Leone	-18.6	-31.0	-140.3	39.4	39.4
Somalia	..	-0.7	-0.1	-11.4	..
Sudan	..	-2.8	..	..	..
Tanzania	4.6	14.5	-7.2	..	..
Togo	42.3	16.7	2.7	2.7	2.7
Uganda	4.0	-4.0	..	..	3.0
Vanuatu	2.7	4.6	2.0	12.9	10.8
Yemen Arab Republic	33.8	3.4	5.4	1.0	1.0
Yemen, People's Democratic Republic of	..	..	..	1.0	8.0
Western Samoa	..	..	..	1.0	..
TOTAL	323.5	134.7	1.9	215.9	188.0
Developing countries	10 886.0	13 293.9	13 876.0	23 552.9	25 096.6

Source: United Nations Centre on Transnational Corporations, based on IMF Balance of Payments Tape.

7. In so far as foreign investment is considered desirable, host least developed countries themselves need to implement various actions to complement whatever home country measures are in force or may be adopted in the future. Those actions relate to many areas, ranging from an appropriate macro-economic policy régime to legal and administrative arrangements concerning entry, ownership and operating conditions affecting transnational corporations. These were also discussed in detail in the report submitted to the Commission last year and have not been addressed here.

8. Finally, it should be noted that each least developed country must define for itself the nature and the extent of contribution from transnational corporations in the context of its own economic and social aspirations. As conditions for transnational investment become more conducive, there arises a greater need for least developed countries to develop the capacity to ensure that such investment makes a net positive contribution to their economies.

I. SYNOPSIS OF HOME COUNTRY AND MULTILATERAL MEASURES

A. Specific incentives and promotional measures

1. Fiscal incentives

9. Most Development Assistance Committee (DAC) countries have signed bilateral agreements with developing countries to avoid double taxation. 4/ In the absence of a double taxation treaty, some of them have special provisions to mitigate the effects of double taxation or to avoid nullifying fiscal incentives given by developing countries. Australia, Belgium, Canada, the Federal Republic of Germany and France apply tax sparing credit as a fiscal incentive against taxes temporarily foregone by a developing country with which they have signed a bilateral tax agreement. In their tax treaties with developing countries, Finland and Sweden allow for higher taxation in the host country, in which case the head office would generally be exempt from income tax on dividends from a subsidiary. In addition, depending on the tax method used, both Finland and Sweden either exempt from domestic income dividends paid by a foreign subsidiary or give a tax credit for taxes spared through incentives granted by a developing country. Japan provides some tax benefits for certain categories of investment in developing countries by permitting the establishment of loss reserves eligible for tax deduction. The Netherlands, through the "Unilateral Decree" on the avoidance of double taxation, credits any tax levied by a developing country against a company tax levied in the Netherlands. In the case that the foreign tax cannot be fully offset against the amount paid in the Netherlands in one year, the Decree allows the balance to be offset against the same type of income in the following eight years. The Republic of Korea allows tax deductions and exemption of dividend income taxes under certain conditions. The United Kingdom, in some of its double taxation treaties with developing countries, has included "matching credit" provisions which prevent industry tax relief by developing countries from being undermined by corresponding increases in the United Kingdom. The basic underpinning of the United States tax system is one of neutrality between foreign and domestic investment. The United States, therefore, does not offer any major fiscal concessions for investment in developing countries. However, in some of its bilateral tax treaties, the definition of an income tax has been modified in such a way that taxes which, otherwise, probably would not qualify for foreign tax credit, do so.

2. Financial incentives

(a) Development finance at the bilateral level

10. Ten Development Assistance Committee members have established public development finance corporations to encourage private investment in developing countries. While the functions of public development finance corporations can vary from country to country, they all act as investment banks and/or development agencies. They also can exert considerable leverage in mobilizing capital. This is due to the fact that public development finance corporations enjoy the trust of home country investors because of their rigorous financial standards and the degree of security that they add to investment. Governments of host countries appreciate

public development finance corporations because these institutions insure a certain degree of development orientation by foreign enterprises. All public development finance corporations require host governmental approval of the projects that they finance. They usually take minority positions in projects financed by home and/or host country investors, invest in both loan and equity and do not normally require host country guarantees or collateral for their loans. Once a new venture is on stream and profitable, public development finance corporations generally offer to sell their equity share to their partners, with preference to recipient country residents. Public development finance corporations normally assist small and medium-sized enterprises from their home countries, although recommendations have been made that they expand their operations to include other companies. The accompanying box gives examples of the operations of a few public development finance corporations (see box 1).

Box 1. Public development finance corporations

The Finnish Fund for Industrial Development Corporation Ltd. is a joint stock company of which the Government's share is 92 per cent of the capital. The Fund promotes the initiation, establishment and expansion of joint ventures between Finnish and developing country entrepreneurs. At the end of 1987, it had 23 investment commitments in 16 countries, totalling $40 million in equity, loans or guarantees. The German Finance Company for Investment in Developing Countries is 100 per cent owned by the Government of the Federal Republic of Germany and has an authorized capital of DM 1 billion. Its mandate is to support the development of an economic infrastructure in developing countries by initiating new joint ventures and partly financing the project; granting loans to small- and medium-size enterprises; and financing research projects evaluating the feasibility of specific joint ventures. The German Finance Company is one of the few financial institutions in an industrialized country that is able to provide risk capital as well as long-term loans for private joint ventures in developing countries. The Government of Japan provides financial facilities to Japanese investors mainly through the Export Import Bank of Japan and the Overseas Economic Co-operation Fund. In addition to its other facilities, the Bank provides credits to support Japanese foreign investment. In 1987, the Bank's total credit commitments amounted to Yen 1,405.6 billion. The Fund mainly extends concessional official development loans to the Governments of developing countries; however, it also supplies funds in the form of long-term soft loans for projects by Japanese enterprises if the projects promote economic development of the countries concerned. The Netherlands Development Finance Company has as its objective the stimulation of growth of the productive sector in developing countries through participation in equity capital or by providing capital and/or medium- and long-term loans to local enterprises. It also provides assistance for feasibility studies, pilot projects, investment promotion seminars and missions and management and employee training. The Government of the Netherlands holds 51 per cent of the shares, with the balance owned by the Dutch business community. By the end of 1988, the company had provided the equivalent of $300 million to some 150 projects in 41 developing countries. The Republic of Korea provides financial assistance to promote overseas investment through the Export-Import Bank of Korea. The Swedish Fund for Industrial Co-operation with Developing Countries, which has an authorized capital of $40 million, acts as a broker between interested parties in developing countries and the Swedish business community; it finances in part feasibility studies and contributes to joint ventures with equity participation and/or loans and guarantees. The United States Overseas Private Investment Corporation operates three main programmes: it provides insurance for United States private investments in more than 100 developing countries against certain political risks; it promotes United States foreign investment in developing countries; and it finances projects sponsored by eligible United States investors in those countries. The institution is self-sustaining. Its revenues are used to provide insurance and guarantee reserves, promote United States small business abroad and pay the organization's operating expenses. In 1987, it committed $223 million and in 1988, $238.68 million in direct loans and loan guarantees to finance projects in developing countries. Also in 1987, the Corporation established the Africa Growth

Fund to make equity and equity-like investments in new or expanding business in sub-Saharan Africa. The Fund provides investment capital and management services for the development of new productive ventures, the expansion of existing private sector companies and privatizations of state-owned enterprises in that region. The Corporation is committed to provide $20 million in guarantees and political risk insurance, but the Fund is owned and managed by private companies.

11. Apart from the public development finance corporations, some developed countries provide encouragement to investment in developing countries through other institutional arrangements. The Australian joint venture scheme is designed to provide Australian development assistance funds to enable the equity purchase by South Pacific countries in joint ventures with Australian partners. The Pacific Islands Industrial Development Scheme of New Zealand provides financial assistance in the form of grants and loans to New Zealand businesses establishing or expanding manufacturing or processing operations in the South Pacific Island Countries. The Government of the Federal Republic of Germany has put together a mechanism to provide loans and credits from the federal budget to encourage corporate investments in developing countries. These loans and credits are used for partly financing investment projects or for financing field studies to evaluate future investments. The loans are granted for the establishment, expansion or buy-out of a company in a developing country. Small and medium-sized enterprises are eligible for these loans. The applications go through a private bank, DEG or the Ministry for Economic Co-operation to the Credit Union for Reconstruction. In addition, the Federal Ministry for Economic Co-operation grants loans to small- and medium-sized German enterprises for establishing or restructuring joint ventures in developing countries which use new technologies in their production. The loans are meant to minimize the risks for a company from that country and to introduce new products and technologies to developing countries.

(b) Development finance at the regional and multilateral level

12. There are also financial schemes or funds at the regional level offering financial assistance similar to that offered by public development finance corporations. These schemes or funds can have as members public development finance corporations or other financial institutions of the participating countries. This is the case for the European Economic Community's International Investment Partners scheme. It was launched in June 1988 on an experimental basis with the objective of providing financial support for operations related to private sector investment projects in the form of joint ventures between firms in the European Economic Community and firms in certain countries in Latin America, Asia and the Mediterranean region (see box 2 for a description of measures adopted by the European Economic Community to reduce regional disparity within the Community). The principal characteristics of the scheme are: complementarity, so that existing arrangements by financial institutions are not duplicated but complemented; a decentralized approach, based on rigorous risk-sharing with financial institutions; and non-bureaucratic operations, in that the scheme is operated by a very small staff. Services and procedures have been developed with a view to providing rapid decisions on applications. The scheme offers financial support for the following types of operations: identification of potential projects and partners; operations connected with the launching of a specific joint venture; financing of capital requirements; and development of training and management expertise.

13. Alternatively, a financial assistance fund can be created by Governments, such as the NORSAD Fund between the Nordic countries and the Southern African Development Co-ordination Conference member States. The NORSAD Fund is

complementary to the Nordic public development finance corporations and is intended to promote investment and trade by Nordic enterprises in the Southern African region by guaranteeing to eligible companies the availability of convertible currencies for their requirements for essential inputs for their operations during a reasonable period of time. The initial capital of the fund is 200 million Danish Kroner provided by the four Nordic countries.

14. The International Finance Corporation also invests in equity and makes loans, like bilateral public development finance corporations. In addition, the International Finance Corporation provides co-financing and organizes commercial banks' participation in its loans. Its investments are increasingly concentrating on rehabilitating existing companies rather than starting new plants.

Box 2. Measures by the European Economic Community to reduce regional disparity

In a multilateral context, the principle that the reduction of disparities in development between regions is a desirable goal has found its practical application in the European Community. Based on the premise that continued disparities are an impediment to economic and social cohesion within individual member countries and between them, the Community has used a number of instruments for the reduction of such disparities.

Among those instruments are the European Investment Bank, which gives loans for public and private investment in infrastructure and industry; the European Coal and Steel Community, which assists in the modernization of coal and steel industries; the European Social Fund, which finances training and retraining of workers; and the European Agricultural Fund, which offers assistance for the modernization of agricultural production and marketing. Though these schemes are not specifically aimed at alleviating regional disparities, these have a strong orientation towards that end. For example, nearly two thirds of 42 billion ECU lent by the European Investment Bank between 1958 and 1986 was for regional development; 45 per cent of the aid provided by the European Social Fund is reserved for less developed regions.

In 1975, the Community set up a fund, the European Regional Development Fund, exclusively for the purpose of reducing regional disparities. Since its inception, the Regional Fund has disbursed 17.5 billion ECU in grants for public and private investments in infrastructure, industrial, services and craft activities. Up to 1986, the European Regional Development Fund budget increased 12 fold to 3.3 billion ECU. The aid comprised a total of 33,000 individual investment projects, and 8,559 co-financing projects leading to the direct creation/preservation of 765,000 jobs and probably a similar number of indirectly created jobs. Until 1985, almost all European Regional Development Fund spending was subject to national quotas which set out the exact proportions of the fund to be allocated to each member State. The quotas were calculated in such a way that, although members with per capita gross domestic product below the Community average received the largest share of European Regional Development Fund resources, the more affluent members also received some support.

The reforms of 1985 brought a more flexible procedure. The quota arrangement was replaced by a system of "indicative ranges" which define the minimum and maximum allocations each member can receive from the European Regional Development Fund. The introduction of indicative ranges was combined with an increase in the rate of assistance from 30 per cent to 50 per cent of project costs. This change meant that not only would European Regional Development Fund assistance be a more important element in the financing of particular projects, but also that competition for available finance would be increased since fewer projects could now be funded.

In 1987, the Fund disbursed over 3.5 billion ECU, thereby creating or maintaining 66,000 jobs. Nearly 90 per cent of assistance went to six member countries (Greece, Ireland, Italy, Portugal, Spain and the United Kingdom) with greater regional disparities. The assistance amounted to as high as 3.9 per cent of gross fixed capital formation in Greece and 5.3 per cent in Portugal. 1/

1/ "Europe's regional policy", Europe (January-February, 1988).

3. Other promotional activities

(a) Bilateral information and promotion services

15. Most developed countries offer information and promotion services to encourage their enterprises to invest in developing countries. The services vary among countries. On the whole, however, they may include the following: identification of business opportunities in developing countries; reimbursement of costs for pre-investment and feasibility studies; investor information services; organization of investment missions; advisory services to officials in developing countries for the creation of an environment conducive to private sector development; and incentives for the creation of joint ventures. These information and promotion services can be offered by an independent body created specifically for the promotion of outward foreign investment, or they can be offered by a separate entity within a public development finance corporation.

16. The Canadian International Development Agency offers support to Canadian enterprises wishing to invest in developing countries, regardless of the enterprise's size. Through the Agency's Industrial Co-operation Programme, Canadian business is encouraged to serve as a development tool for the industrialization of developing countries through mutually beneficial investment, transfer of technology and joint ventures. The programme can assist Canadian firms in investigating the establishment of long-term business collaboration in developing countries by financing part of the cost associated with the development of joint ventures. In 1984, the Government of the Federal Republic of Germany initiated the Programme for the Promotion of Business Co-operation as an advisory service for small- and medium-sized enterprises wishing to invest in developing countries. The programme provides practical assistance by establishing contacts and identifying business partners. Italy is in the process of developing Mondipresa, a fund of about $100 million to assist in the creation of joint ventures between Italian firms and firms from developing countries. The project is being managed by the Ministry of Foreign Affairs. The services offered by Mondipresa fall under the following three main categories: provision of information; essential services; and a roster system of experts. A documentation centre on joint ventures collects information on techniques and procedures for the promotion of investment and on the priority countries for co-operation, with particular regard to those most suited for industrial co-operation. The general information is analysed and distributed through the Ministry of Foreign Affairs and through a network of local chambers of commerce. The services provided comprise the following activities: identification of Italian firms, identification of partners in developing countries and identification and linkage with support organizations; organization of meetings with partners on-site; assistance in organizing overseas missions; and creation of a central pool for essential services offering personalized information to Italian and foreign enterprises for identifying specific projects on joint ventures and other forms of collaboration. The roster of experts is developed to give guidance to firms in their first ventures in development co-operation.

17. The Norwegian Ministry of Development Co-operation supports Norwegian firms wishing to invest in developing countries on the condition that the project meet

the development needs of the countries concerned. Within the Netherlands development finance corporation, there is a separate investment promotion service which was created in March 1989 to promote foreign investment in developing countries through the financing of feasibility studies and pilot projects, the training of personnel and the funding of targeted promotion missions. Similarly, the Overseas Private Investment Corporation in the United States offers several investment encouragement activities. These include the Investment Mission Programme, the Opportunity Bank, a computerized data base matching United States companies with investment projects in developing countries, and the Investor Information Service, offering to United States investors basic information about developing countries and their business environment. In addition, the Agency for International Development has an investment promotion and export diversification component in its programmes. In the Latin American and Caribbean region, it has established organizations to attract United States investors and assist local exporters, offering the following services: feasibility and marketing studies, joint venture brokering and legal and investor advice. For Africa, the Agency has created the Market Development and Investment office to assist private sector development in Africa.

(b) Multilateral information and promotion services

18. The International Finance Corporation created the Business Development Division in April 1988. The Division's mandate is to generate business opportunities through contacts with enterprises and institutions from developed countries in order to complement and support the promotional efforts of the corporations' investment departments. The Centre for the Development of Industry was created by the first Lomé Convention between the members of the European Economic Community and African-Caribbean-Pacific (ACP) States to finance feasibility and pre-investment studies and to organize joint ventures between enterprises from the two groups of countries. In addition, the Community has launched a number of industrial promotion activities ranging from the funding of pre-feasibility studies for regional export industries to the publishing of manuals on how to set up firms in African-Caribbean-Pacific States. The United Nations Industrial Development Organization (UNIDO) has established Investment Promotion Services in seven developed market economy countries, and in Poland and in the Republic of Korea. The services, which are partly financed by the host country in which they operate, promote investment projects and technology transfer to developing countries. They assist businesses in the countries where they operate in identifying industrial investment opportunities in developing countries and draw investor's attention to project proposals.

B. Improving protection and predictability

19. Establishing international investment norms that safeguard a foreign investor's capital is considered as one of the ways to encourage foreign investment in a developing country. The following paragraphs briefly describe some of the measures designed to achieve that end.

1. Bilateral investment treaties

20. Most developed countries have signed bilateral investment treaties with developing countries. These treaties contribute to a better investment climate and can encourage private economic co-operation by guaranteeing fair and equitable treatment of foreign investors through the protection of foreign investments. The number of treaties signed varies among developed countries with the Federal Republic of Germany having signed the largest number. As of mid-1987, there were 24 least developed countries which were signatories to such bilateral agreements with one or more developed countries. 5/

2. Investment guarantee schemes

21. Home countries administer investment guarantee schemes to cover certain economic and political risks of investment in developing countries. They are adopted by all developed countries, with the exception of Norway (which has suspended its old guarantee system pending adoption of a new one), to cover problems regarding inconvertibility of local currency for dividend remittances, expropriation and loss due to civil strife. The coverage for individual home countries varies widely. Table 3 presents in summary form the investment guarantee schemes offered by most developed countries. For the countries that do not appear on the table, no information was available. In a more recent development, Japan's Ministry of International Industry and Trade decided to strengthen its underwriting of investment by Japanese firms in about 50 developing countries regarded as high investment risks.

3. Multilateral investment arrangements

22. The International Centre for Settlement of Investment Disputes was created under the auspices of the World Bank to settle disputes between host governments and foreign investors. By offering the possibility of settling such disputes by conciliation or arbitration, the Centre seeks to encourage the growth of private foreign investments. A growing number of investment agreements include provisions to submit future disputes to the Centre, and a number of host countries have adopted legislation to accept the Centre's jurisdiction. Table 3 also summarizes two multilateral investment guarantee schemes. The scheme administered by the Multilateral Investment Guarantee Agency of the World Bank is intended as a measure of protection against non-commercial risks. The Guaranteed Recovery of Investment Principal administered by the International Finance Corporation facilitates foreign direct investment in developing countries by removing the threat of capital loss.

Table 3. Investment guarantee schemes by developed countries and multilateral agencies

Country/multilateral agency	Administration	Type of risk covered	Criteria for coverage
Australia	Export finance and Insurance Corporation	Expropriation, exchange transfer blockage, war damage	
Austria	Osterreichische Kontrollbank	Three main political risks	Applies to both developed and developing countries.
Belgium	Office National du Ducroire	Political risk	Project must contribute to the economic and social development of recipient country; it must promote Belgium's economic interests abroad.
Canada	Export Development Corporation	Transfer of funds, expropriation, war, revolution or insurrection	Scheme available only to new investments.
Denmark	Danish International Development Agency	Three main political risks	New investments only, where investor has control over enterprise. Investment must have positive developmental effect on host country economy.
Finland	Export Guarantee Board	Expropriation, serious disturbance in economic condition of host country, restrictions in capital and earnings repatriation	Investment must be in form of equity participation, loans or loan guarantees, or licensees.
Federal Republic of Germany	Interministerial Committee from Ministries of Economics, Finance, Foreign Affairs and Economic Co-operation	Expropriation, nationalization, war, revolution, non-transferability of capital and earnings	New investment, positive effect on home and host country economy. Situation in host country must appear satisfactory at time of approval with respect to legal protection against political risks. Existence of bilateral investment treaty is a pre-condition.
Japan	Ministry of International Trade and Industry	War, expropriation, exchange transfer and commercial risk (bankruptcy)	Direct investment by Japanese or non-Japanese company. Portfolio investment and long-term loans for Japanese and non-Japanese companies if engaged in exploitation of mineral and natural resources.

Table 3 (continued)

Country/multilateral agency	Administration	Type of risk covered	Criteria for coverage
Netherlands	Netherlands Credit Insurance Company	Expropriation, nationalization, war, revolution, non-transferability of capital and earnings	New investments in developing countries, subject to satisfactory procedural arrangements for dealing with disputes.
New Zealand	Export Guarantee Office	Exchange transfer expropriation, war damage	New equity investments
Norway	System presently suspended	New system under evaluation	
Sweden	Swedish Export Credits Guarantee Board	Currency transfer, expropriation, and war	Investment must have positive impact on Swedish economy.
Switzerland	Department of Economics	Three main types of political risk	Equity participation, only new investments promoting economic development of host country and reinvested earnings.
United Kingdom	Export Credits Guarantee	Expropriation, war, restriction of remittances	New investments, assisting in the development of host country.
United States	Overseas Private Investment Corporation	Currency inconvertability, expropriation, political violence	
World Bank	Multilateral Investment Guarantee Agency	Issue of guarantees including insurance with, and re-insurance of existing political risk insurers. In addition risks covered include creeping expropriation, currency inconvertability.	Projects of clear development interest for host country.
International Finance Corporation/ Guaranteed Recovery of Investment Principal	International Finance Corporation	Threat of capital loss	Benefit host country economy, project must show financial promise.

Source: Organisation for Economic Co-operation for Development, "Development co-operation for private sector development including foreign direct investment: a compendium of measures", (Paris, OECD, 1988), mimeo.

/...

23. The European Economic Community and the African-Caribbean-Pacific States have undertaken a joint study on an investment protection scheme with a view to encouraging foreign investment in the African, Caribbean and Pacific region. The study covers the scope and appropriate mechanisms of an insurance and guarantee system that would be complementary to existing national systems and is expected to have a positive effect on the flow of private sector resources from the Community to the African, Caribbean and the Pacific States. A draft report on this study is being prepared for presentation to the appropriate bodies within the two groups of countries.

C. Trade measures

24. In addition to the measures described above, there are a number of trade related programmes at the bilateral and multilateral level giving preferential access to exports from developing countries. These measures may encourage transnational corporations to choose developing countries as locations for investment in the production of export-oriented products. The Federal Republic of Germany provides financial support for an annual trade fair in Berlin with a view to promoting exports from developing countries; the Government of the Netherlands assists export promotion at the company level through support for market research, technical advice and product development. Under the Caribbean Basin Initiative, which came into effect in 1984, the United States encourages its firms to enter into manufacturing arrangements with Caribbean Basin-based firms guaranteeing duty-free access to the United States of the products manufactured in the Caribbean countries. In conjunction with this, the United States has extended increased economic assistance to the countries in the region to aid private sector development. In order to qualify for duty-free entry under the Caribbean Basin Initiative, a product must meet the following specifications: it must be grown or manufactured in one or more of the 22 qualifying countries and exported directly to the United States; the direct processing costs in a country must total at least 35 per cent of an article's customs value, or 20 per cent with the additional 15 per cent attributable to components made in the United States; and the final product must be an article of commerce that is "new and different" from any foreign materials used in its manufacture, achieving this transformation with significant effort. The programme excludes certain categories of products from duty-free entry. 6/

25. In addition to the Caribbean Basin Initiative programme, items 806.30/807.00 of the Tariff Schedules of the United States provide for reduced duties for products of United States origin assembled or processed outside of the United States under certain circumstances. Under these provisions, customs duties are paid only on the value-added to the goods as a result of processing or assembly in a foreign location. Under item 806.30, metal articles manufactured in the United States, exported for processing and then returned to the United States, are assessed for duty on the difference in value between the finished, reimported items and the original United States export. Item 807 operates on the same principle but applies to other operations in which components manufactured in the United States are assembled overseas and then returned, as long as they do not lose their physical appearance or identity in the foreign assembly process.

26. Under the Generalized System of Preferences, 21 developed market economies and 6 socialist countries grant preferential tariff treatment to imports, mainly of manufactures and semi-manufactures, originating from developing countries. The preference-giving schemes vary among the preference-giving countries as to the beneficiaries, product coverage, tariffs imposed, safeguard measures, rules of origin, graduation of beneficiary countries and treatment extended to the least developed countries. With regard to the latter, a number of preference-giving countries extend additional benefits to them. For example, in January 1984, the European Economic Community introduced a system of derogation whereby the rules of origin would be liberalized in favour of the least developed countries on a case-by-case basis. In September of the same year, Austria extended duty-free treatment for textile handicraft products originating in the least developed countries. In the same year, Japan introduced a special duty-free rate in favour of the least developed countries with respect to imports of woven fabrics of jute. Czechoslavakia and Hungary added countries in the list of least developed countries which enjoyed duty-free treatment under their schemes.

27. The Lomé Convention, administered by the European Community with respect to African-Caribbean-Pacific States, many of which are least developed countries, grants special privileges to those States. The principal provisions of the Convention cover the following matters: trade co-operation, stabilization of export earnings, mineral products, industrial co-operation and financial and technical co-operation. Under trade co-operation, goods originating in the African-Caribbean-Pacific States are, with some exceptions, to be admitted into the Community duty free. In return, the European Economic Community States are entitled to most favoured nation treatment in ACP markets. Under the stabilization of export earnings system, exports to the Community of products on which the economies of the ACP States are dependent and which are affected by fluctuations in price or quantity or both, are entitled to certain compensatory payments. The products eligible for the system are mainly unprocessed agricultural products, with the exception of iron ore. 7/ Under support for mineral production, a system has been established to assist the ACP States in their efforts to remedy the harmful effects on their income of serious temporary disruptions, which are beyond their control, affecting mining sectors of importance to them. Assistance under this arrangement is in the form of contributions to clearly defined projects. Under industrial co-operation, the two parties undertake to accord investors fair and equitable treatment, stable conditions conducive to investment, and a joint commitment to maintain a predictable, safe investment climate. Under financial and technical co-operation, the objective is to promote the economic and social development of the concerned developing States on the basis of priorities laid down by those States and in the mutual interest of the parties.

28. The Global System of Trade Preferences is a multilateral arrangement subscribed to by developing country members of the Group of 77. The System provides a framework for trade relations among these countries on a preferential basis. Its objective is to promote and sustain mutual trade and the development of economic co-operation among developing countries through the exchange of concessions. The agreement covers not only tariffs but also para-tariffs, non-tariff measures, direct trade measures and arrangements related to sectoral agreements.

II. SOME POLICY CONSIDERATIONS

29. The preceding section has briefly described the measures adopted by major home countries and multilateral institutions which are likely to encourage transnational corporations to play a greater role in the least developed countries. The information that could be collected in the course of preparation of the present report is, by no means, exhaustive. As noted before, most of the measures are not specifically directed towards least developed countries, and very little information is available as to the extent to which least developed countries have been able to actually avail of the existing measures. Consequently, detailed empirical research is required to form the basis of policy recommendations. Nevertheless, certain areas which deserve the attention of policy makers are identified below.

A. Removal of home country disincentives for outward investment

30. Outward direct investment is unconstrained in most developed countries, and there is no distinction whether it flows to developed or developing countries. Belgium, Canada, the Federal Republic of Germany, the Netherlands, Switzerland, the United Kingdom and the United States neither prohibit nor request prior approval for their firms to invest overseas. Some home countries, however, impose certain requirements for granting such approval, and these requirements can be considered as a disincentive.

31. Italy, for instance, allows export of capital; however, it requires that the lira equivalent of 50 per cent of the foreign investment be deposited in a non-interest bearing account in the transferring bank. A number of other developed countries, such as Australia, Austria, Finland and New Zealand, authorize export of capital depending on the expected economic impact of the investment on the host country's economy. Denmark and Japan require prior authorization for investments exceeding a certain amount, while Norway requires prior authorization in all cases. Sweden allows its residents to transfer capital only if certain conditions are met. France allows free export of capital to the countries of the franc area, requires prior notification for investment in other European Economic Community members and requires prior official authorization for investment in other countries if the amount exceeds FF 1 million per year, in which case the amount has to be financed from foreign sources.

32. Where any form of restriction on outward investment exists, home countries could consider the possibility of granting special relaxations for least developed countries. For instance, it could be provided that no prior authorization would be needed for investment of any size in a least developed country.

B. Fiscal incentives

33. The available evidence suggests that fiscal incentives for outward investment do not differentiate between least developed and other developing countries. A number of home countries further require the existence of a double taxation treaty for the eligibility of any tax benefit to be derived from investment abroad.

34. Here again, there is a scope for reviewing the existing incentive measures with a view to granting special privileges to the least developed countries in consideration of the many structural problems with which they are afflicted. In particular, the possibilities of unilaterally granting tax exemptions or higher tax concessions for dividends and profits remitted from least developed countries could be explored.

C. Financial assistance for investment

35. Although detailed information is not available as to the extent to which the least developed countries have benefited from financial assistance to investors for investment in developing countries, it appears that these countries have been, at best, marginal beneficiaries. For instance, in 1988, the Overseas Private Investment Corporation insured or financed 167 projects in developing countries. Of those projects, only 6 were located in the least developed countries. Similarly, out of the $772 million insured investment in developing countries by the Overseas Private Investment Corporation in 1987, only $127 million, or 16.5 per cent, was in the least developed countries, while for 1988 the amount was even smaller. Out of $845 million insured investment in developing countries, only $3.5 million (or 0.4 per cent) was in the least developed countries. 8/ Among 36 countries eligible for participation (as of June 1989) under the European Economic Community's International Investment Partners Scheme, Bangladesh was the only least developed country. 9/

36. All home countries and multilateral organizations could examine measures to facilitate wider participation of the least developed countries under the existing facilities. Perhaps a proportion of available resources could be earmarked for those countries.

D. Information and promotion services

37. The information and promotion services that are offered by a number of home countries to their private sector in order to encourage foreign investment in developing countries do not generally have any particular provisions for least developed countries. Least developed countries also probably do not have adequate information about the availability of existing services; many of them do not even have embassies in the capitals of all major home countries.

38. Both bilateral and multilateral agencies could strengthen measures to increase the flow of information on viable projects in least developed countries that might be of interest to transnational corporations. Embassies of home countries could play a useful role in that regard. Such efforts should be supplemented by assistance to improve the capacity of the least developed countries to identify and formulate project proposals which might interest transnational corporations.

E. Improving protection and predictability

39. It is sometimes argued that one of the elements in creating a climate that insures protection and predictability of returns to investment and thereby provides encouragement to transnational corporations is the existence of treaties or agreements between home and host countries. Table 4 clearly shows that the participation of the least developing countries in bilateral investment treaties or double taxation agreements is extremely low.

Table 4. Bilateral investment treaties (as of mid-1987) and double taxation agreements (as of late 1980s) of selected developed countries

Developed countries	Bilateral investment treaties		Double taxation treaties	
	Total number of countries	Number of least developed countries	Total number of countries	Number of least developed countries
Australia	--	--	23	0
Austria	4	0	28	0
Belgium	19	2	29	0
Canada	--	--	44	1
Denmark	7	1	41	1
Finland	3	0	39	1
France	31	6	47	4
Federal Republic of Germany	70	20	47	0
Italy	9	2	29	0
Japan	2	0	34	0
Netherlands	23	4	37	0
New Zealand	1	0	21	0
Norway	5	0	42	1
Sweden	12	1	49	2
Switzerland	37	13	27	0
United Kingdom	28	5	88	9
United States	10	2	49	1

Sources: United Nations Centre on Transnational Corporations, Bilateral Investment Treaties (United Nations publication, Sales No. E.88.II.A.1); and International Tax Treaties of All Nations: Cumulative Index (Dobbs Ferry, Oceana Publications, 1988).

40. At the empirical level, it has been found that there is little correlation between the existence of bilateral treaties and the flow of foreign investment. 10/ Nevertheless, it could be a visible confidence-building step for transnational corporations. From this point of view, both home and host least developed countries could take greater initiative in signing bilateral treaties and agreements (see box 3 on double taxation).

Box 3. Double taxation agreements

The problem of double taxation arises because the existence of international trade and investment creates the situation whereby a tax-paying entity may be subject to the tax jurisdiction of more than one country in respect of the same income. As the volume of international trade and investment increases, the frequency of double taxation would also increase, unless it is avoided through agreements between countries.

Double taxation has several implications. It implies not only that the same transaction is effectively taxed more than once but also that the sum of these separate taxes is often higher than that levied on other economically comparable activities. The incidence of taxation thus becomes inequitable. Double taxation is a problem, because the heavier the burden of international double taxation, the greater the incentive for international tax avoidance and evasion by individuals and corporations. The opportunities for tax avoidance are greater for transnational corporations that can engage in intra-firm transactions and transfer pricing. Tax avoidance efforts by companies, in turn, may lead to a distortion of economic activity resulting in a net loss of welfare to the national and world economies.

Some developed countries have provisions in their tax codes giving taxpayers unilateral relief against the incidence of double taxation. These do not depend on the existence of a treaty. However, there is also a network of double taxation agreements on a bilateral basis, dealing in more detail with particular issues on the basis of reciprocity. Among the elements addressed in such treaties are: at what rate is the income generated to be taxed; is the tax to be levied by the fiscal authority of the country where the income originates (country of source) or of the country of residence of the tax-paying entity or concurrently; and the limits of jurisdiction. In the context of foreign direct investment, an important issue is whether a tax benefit to encourage investment either by the home or the host country accrues to the investor or is appropriated partly or fully by the other country's treasury. In the latter event, the incentive effect of the tax measure would be eroded or negated.

There are model international conventions which have devised methods for avoiding double taxation by allocating categories of income between the taxpayer's country of source and country of residence. One such model, drafted under the aegis of the Organisation for Economic Co-operation and Development (OECD), places emphasis on the jurisdiction of the country of residence. 1/ An OECD study pointed out that the pattern set by treaties between industrialized countries may not be equally appropriate in treaties between developing and industrialized countries, because income flows are largely from developing to industrialized countries and the revenue sacrifice would be

one-sided. 2/ To remedy this kind of imbalance, changes in the model were found to be necessary. Thus, the United Nations Model Double Taxation Convention between developed and developing countries, proposed in 1980, while largely based on the OECD model, departs from it in specific respects in order to take into account specific conditions of developing countries and likely flows of income. 3/

1/ H. L. Goldberg, "Conventions for the elimination of international double taxation: toward a developing country model", Law and Policy in International Business, vol. 15, No. 3 (1983), p. 836.

2/ OECD, Fiscal Incentives for Private Investment in Developing Countries: Report of the OECD Fiscal Committee (Paris, 1965), para. 164.

3/ United Nations, United Nations Model Double Taxation Convention Between Developed and Developing Countries (United Nations publication, Sales No. E.80.XVI.3).

F. Trade measures

41. As mentioned earlier, some preference-giving countries extend additional benefits to the least developed countries under the Generalized System of Preferences. The rate of utilization varies among the least developed countries; however, in many cases it is quite low. Only a small fraction of total exports from least developed countries receive preferential treatment under the system. For example, in the early 1980s, total imports of 10 developed preference-giving countries under their respective schemes from the beneficiary least developed countries amounted to $1,194 million. However, imports that actually received preferential treatment under the scheme were valued at $63.2 million. 11/

42. Among the reasons for such low utilization are narrow product coverage of exports from least developed countries, requirements of rules of origin and complex documentation procedures required to obtain preferential treatment. Preference-giving countries could consider measures to remove these bottle-necks. Similarly, better terms could be offered to eligible least developed countries under the Lomé Convention; revisions of its terms are currently under negotiations.

CONCLUDING OBSERVATIONS

43. As the introduction pointed out, least developed countries suffer from a variety of structural constraints which discourage transnational corporations from investing in them. Home country Governments also do not seem to make any particular effort to encourage transnationals to invest in least developed countries. In order for foreign investment to flow to the least developed countries, the fundamental problems confronting them, such as low income, slow growth, poor infrastructure and inadequate human resources development, must be addressed in conjunction with any incentives that might be given to transnational corporations. Some ideas for such incentives could be derived from measures adopted by both developed and developing countries to promote investment, domestic as well as foreign, in the less developed areas within those countries (see box 4).

44. The least developed countries, however, do not possess the means to address all these structural problems on their own. Industrialized countries must, therefore, provide the assistance that could correct some of these imbalances. Official development assistance, both bilateral and multilateral, can play a major role in this regard. The particular problems of a least developed country should be carefully taken into account by the appropriate institutions of a donor country agency, and the assistance extended, be it financial aid, or technical assistance, should be carefully tailored to the needs of the least developed country.

Box 4. An illustration of measures to promote investment in less developed regions within countries

Many countries, both developed and developing, offer a variety of incentives to encourage investment in their less developed regions. Some of those measures may conceivably be adapted by home countries to encourage investment by transnational corporations in the least developed countries. From this perspective, an illustrative review of policies adopted to promote investment in less developed regions of particular countries is instructive.

India

The Government of India offers many incentives to companies for locating production in backward areas; some of these are by state governments. Corporate tax incentives for companies that undertake investment in backward areas include tax holidays, exemptions from dividend, interest and wealth taxes, accelerated depreciation and investment allowances, and deductibility of certain expenses. Companies may deduct 20 per cent from taxable income of annual pre-tax profits for 10 years after starting operations. Companies may claim incentives up to 70 per cent of their profits.

Subsidies on fixed-capital investment are available for industries that are set up in the backward districts. In addition, units in these areas qualify for concessional credit. In an effort to speed up ancillary plant construction in the backward areas, industrial units establishing 30 per cent of their operations and increasing employment by three times the existing level qualify as "nucleus" plants, entitling them to a number of concessions which include exemption from sales tax liabilities and further investment subsidies from the respective State governments. In addition, the Central Government subsidizes one half of the transport costs of raw materials and finished goods for industries set up in hilly areas with poor infrastructure.

Italy

The development of the southern half of Italy, referred to as the Mezzogiorno, was entrusted to a government body - the Cassa per il Mezzogiorno - which has co-ordinated the flow of large sums of investment for the purpose of the development of the region.

In 1986, the centralized approach to regional development was replaced by a new approach which transferred substantial power and resources from the Central Government to special regional institutions and local governments. The new policy gives particular attention to small firms and also extends aid for the provision of services with grants of 50-75 per cent of the costs of services. Incentive packages are a combination of tax holidays, cash grants, long-term loans at low interest rates and reductions in social security contributions.

Generous cash grants and loans for Mezzogiorno investments are provided by the central and regional authorities and the European Economic Community. Utilizing the national, regional and the Community systems, a firm can obtain financing for up to 75 per cent of fixed investment costs; agricultural projects can secure as much as 90 per cent of costs. Loans with up to two thirds of interest-rate relief can be obtained for working capital needs. Areas in the Mezzogiorno are classified and updated annually by unemployment, emigration and per capita income to qualify for benefits.

The State-owned Finantziaria Menoclionale provides low-cost leasing facilities and takes a maximum 49 per cent equity as a silent partner. It also advises on plant locations.

Companies formed on or after 29 March 1986 for the specific purpose of undertaking new industrial initiatives in the Mezzogiorno, even if incorporated elsewhere, are entitled to a 100 per cent exemption from corporate and local income tax for 10 years. Capital gains are tax free and value-added tax rebates of 4 per cent of value of new machinery and equipment are available.

For investments in the Mezzogiorno, the research and development budget becomes part of the financial investment plan and receives equal treatment. Research centres in the south employing at least 25 workers can get cash grants worth up to 50 per cent of fixed investment costs. These research and development centres also qualify for reduced social security charges, tax benefits and soft loans.

45. In this context, it may be noted that the resolution referred to at the beginning of the present report also requested a further study of the impact of official development assistance on flows of foreign direct investment to least developed countries. It obviously stands to reason that official development assistance should contribute to inflows of foreign direct investment; but any precise statistical relationship is difficult to establish. The contribution that official assistance can make is only indirect, by bringing about an improvement in the basic administrative, political and economic framework conducive to foreign investment. Econometric studies on determinants of foreign investment rarely include official assistance as an explanatory variable. One recent study finds that official assistance is a significant explanatory variable for foreign investment flows to developing countries from the United Kingdom, but not so in the case of the United States. 12/

46. The least developed countries themselves must implement many actions required to increase the quantitative and qualitative contributions of transnational corporations to their development. These range from macro-economic measures in the realm of monetary, fiscal, trade and exchange rate policies to specific legal and administrative measures directly affecting transnational corporations. 13/

47. There is also a role for home country measures, on which the present report has focused, which are in consonance with the request contained in the relevant resolution. Studies on the effectiveness of incentives by host countries in encouraging foreign investment point to their limited effect on decisions to undertake foreign investment. The main determinants underlying the decision to invest abroad and the form of investment seem principally to concern market prospects and cost factors in the light of overall corporate strategies. Incentives, however, may influence the choice of a location, when other conditions are comparable between alternative locations. 14/ According to the Organisation for Economic Co-operation and Development, a number of countries have been quite successful in attracting investment, including foreign investment, to regional problem areas, although the experience has differed considerably between countries. 15/ In some cases, incentives have been able to generate new investment in these areas, although in other cases, it appears that the main effect has been the diversion of investments from one part of the country to the other. In so far as host country incentives are effective in influencing investment location decisions, home country policies may also influence such decisions. In the context of the least developed countries, what is particularly important is that concerted action is required by all parties - home countries, multilateral institutions and the least developed countries - and on a number of fronts simultaneously.

Notes

1/ Official Records of the Economic and Social Council, 1989, Supplement No. 10, (E/1989/28/Rev.1), chap. I. A.

2/ E/C.10/1989/6.

3/ Ibid.

Notes (continued)

4/ Organisation for Economic Co-operation for Development, "Development co-operation for private sector development including foreign direct investment: a compendium of measures" (Paris, OECD 1988), mimeo. See also Charles R. Irish, "International income taxation and less developed countries" (March, 1986), mimeo.

5/ United Nations, Bilateral Investment Treaties (United Nations publication, Sales No. E.88.II.A.1).

6/ Textiles and apparel, canned tuna, petroleum and petroleum products, foot wear, certain leather products, rubber and plastic gloves, luggage, handbags, watches and parts of watches if any components originated in a socialist country.

7/ However, items such as sugar, citrus, tobacco, veal and beef are excluded from the list.

8/ Overseas Private Investment Corporation, Development Report, various issues.

9/ European Economic Community, "International invest partners" (Brussels, undated), mimeo.

10/ United Nations, Transnational Corporations in World Development: Trends and Prospects (United Nations publication, Sales No. E.88.II.A), p. 333.

11/ United Nations, Operation and Effects of the Generalized System of Preferences (United Nations publication, Sales No. E.87.II.D.1).

12/ F. N. Burton, "Determinants of foreign direct manufacturing investment in developing countries" (April 1989), mimeo.

13/ For an elaboration, see the report of the Secretary-General on the "role of transnational corporations in the least developed countries" (E/C.10/1989/6), pp. 10-16.

14/ Organisation for Economic Co-operation for Development, Investment Incentives and Disincentives: Effects on International Direct Investment, chap. II, (Paris, 1989).

15/ Organisation for Economic Co-operation for Development, "Restructuring the regions: analysis, policy model and progress" (Paris, 1986), mimeo.

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WORK RELATED TO THE CODE OF CONDUCT ON TRANSNATIONAL CORPORATIONS AND OTHER INTERNATIONAL ARRANGEMENTS AND AGREEMENTS: CODE OF CONDUCT ON TRANSNATIONAL CORPORATIONS

Progress made in the work on the code of conduct on transnational corporations

Report of the Secretary-General

SUMMARY

Informal consultations on the code of conduct intensified during the past year. They were preceded by a symposium at which a number of personalities in the field of international economic law suggested some prescriptions for the resolution of the outstanding issues in the code. The outcome of that effort is discussed in the first part of this report.

Since negotiations on the code were initiated in 1976, there have been a number of significant developments affecting the economic and political environment for the code negotiations. Those encompass an array of macro-economic changes which emphasize the linkages between trade, investment and financial issues, leading to a more integrated policy approach to related issues. As a major organizational vehicle for this integration, transnational corporations must of necessity be a focal point in current policy considerations. The new policy dynamic stresses the need for an international framework to address the essential economic functions performed by these corporations.

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* E/C.10/1990/1.

At the same time, changing foreign direct investment patterns have altered the traditional geo-political pattern of home and host country roles, laying the basis for similar alterations in their outlook of specific transnational corporation issues still being debated in the code negotiations.

The impact of change and the opportunities for a successful conclusion of the code negotiations found in the new investment environment are examined in the second and third part of this report, the latter focusing on the interrelationships between the Code and the Uruguay Round of Multilateral Trade Negotiations on services. An evaluation of the main findings in these sections leads to the conclusion that the draft code provides the appropriate framework to deal effectively with current and emerging transnational corporation issues in the new policy environment.

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INTRODUCTION

1. As its fifteenth session, the Commission on Transnational Corporations requested the United Nations Centre on Transnational Corporations to prepare a report for its sixteenth session on the status of the negotiations on the code of conduct on transnational corporations. The present report has been prepared in response to that request.

2. Chapter I reviews the progress made on the code negotiations since the last Commission session. Chapter II analyses a number of recent developments in international economic relations involving foreign direct investment, and their impact on the code negotiations. Chapter III considers the interrelationships that exist between the code of conduct and the Uruguay Round of Multilateral Trade Negotiations, and how those negotiations may facilitate the conclusion of the code. In the concluding part, the prospects for an early conclusion of the code are discussed in the light of the findings of the proceeding sections.

I. PROGRESS ON THE CODE NEGOTIATIONS

3. In resolution 1989/24 the Economic and Social Council, endorsing a consensus proposal by the Commission, reaffirmed the need to finalize the code of conduct on transnational corporations as soon as possible, and requested the Chairman of the special session of the Commission on Transnational Corporations, in co-ordination with the Executive Director of the United Nations Centre on Transnational Corporations, to intensify consultations with the view of resuming negotiations on the code in the context of the special session of the Commission, possibly no later than the end of 1990. Pursuant to that resolution, a number of efforts were undertaken aimed at facilitating a decision on the resumption of formal negotiations on the code.

4. A group of eminent personalities in the field of international economic law gathered at the Peace Palace, the Hague, on 15-16 September 1989 for a symposium on the outstanding issues in the code of conduct. The purpose of the symposium was to facilitate constructive discussions among high-level international experts, with the aim of assisting the Commission in the negotiation of those issues. An important task for the group was to review the outstanding issues in the light of recent State practice, decisions of international tribunals, treaties and other sources of international law; to determine the status of evolution of international law in the relevant areas; and to suggest ways in which the interaction between international law, national law and the code instrument could facilitate the formulation of the code standards. The participants noted several recent changes in the economic scene of relevance to the code. To most observers, the developments have rendered the need for the code - that is, a global, comprehensive and balanced framework on foreign direct investment and transnational corporation activity - more acute than before, because they emphasize the growing significance of transnational corporations in the world economy and increase the importance of concluding international standards to guide essential economic functions undertaken by those corporations. It was also stressed that the fundamental need for the

international community to address the consequences of the operations of transnational corporations by international standards to supplement national law in that area has not changed. With respect to the outstanding issues, it was generally felt that agreement on the code was likely to be found by means of flexible formulations that accommodate different views rather than on the basis of the legal merits of one or another alternative. There were not strong objections to the present formulations in the code, and, in the view of most commentators, the present format of the code was feasible. The participants made a number of suggestions on specific outstanding issues. These are reflected in the report on the symposium, which is reproduced in the annex below.

II. A CHANGING INVESTMENT ENVIRONMENT

5. Last year's report to the Commission on the code of conduct outlined a number of recent developments in international economic conditions and relations of relevance to the code. Those developments and their implications for current code discussions have been further analysed in a recent study prepared by UNCTC. 1/ The main findings of that study are summarized in the present report.

6. The birth of numerous independent and sovereign States and the expansion of transnational corporations in the period after the Second World War gave impetus to the debate on a code of conduct for transnational corporations. Support for the code emerged primarily in the developing world but also in the industrialized home countries of transnational corporations, particularly in academia and among the ranks of organized consumer, environmental and labour groups. In the case of the latter, fear of job loss through transfer of plants abroad raised intense and active interest in the elaboration of standards on corporate responsibility, concerning, in particular, information disclosure and labour management relations for transnational corporations. These and other concerns of a transnational nature, such as the discovery of widespread use of illicit payments by transnational corporations to obtain business abroad, led some of the major industrialized countries in that early period to press for international standards for foreign investment at the United Nations. The Intergovernmental Working Group entrusted with the preparation of the code reached tentative agreement, in a very short time, on the large majority of the provisions of the draft code, including most of the provisions in the section dedicated to the behaviour of transnational corporations. Later, efforts by the Commission led to agreement on the definition of transnational corporations and to substantial progress on the treatment issues, notably on non-interference in internal host country affairs; fair and equitable treatment standards for corporations; jurisdiction, settlement of disputes and transparency of national norms. While the Commission on Transnational Corporations proceeds with the negotiation of the outstanding issues in the draft code, progress has occurred on a wide range of specific instruments relating to transnational corporations. Numerous other international negotiations are under way, covering a wide range of functional and sector-specific issues.

A. Recent changes of relevance to the code

1. Macro-economic changes

7. Important macro-economic changes since the mid 1960s have shaped the nature of international policy issues in the current global system. International trade dominated the early period, but rapid transnational corporation expansion progressively tied national economies together and laid the foundation for an interdependent international economy. Investment issues joined trade concerns on the international agenda during the 1970s, as petro-dollar recycling and the collapse of the Bretton Woods system introduced new international monetary concerns. New financial issues emerged in the 1980s when the debt crisis and currency realignments became a focus of increasing public interest and concern. These phenomena are related in many complex ways. The macro-economic context in which these issues had to be considered linked together questions relating to trade, investment and the management of monetary aggregates. Against that background the rigid categories used in the past on the analysis of policy issues have proved inadequate, and the development of a more appropriate policy dynamic has required a new synthesis. In searching for that synthesis, the activities of transnational corporations have been a focal point, drawing together through their day-to-day activities many disparate strands of policy. In that context the international community looking at the interplay of those policy issues may need a normative framework as a yardstick or gauge.

8. The relevance of this more integrated policy environment for transnational corporation-related issues is suggested by the emergence of such new mechanisms as debt-to-equity swaps, whose financial benefits may be contingent on assurances that the resulting direct investments will yield trade-generated foreign exchange earnings. New interrelationships are also evident in debates about investment regulations that govern trade in services, or the effects of so-called trade-related investment measures (TRIMs) that often involve governmental incentives and disincentives covering a range of trade, investment and financial policies.

9. Another development that reflects the growing policy linkage between trade, investment and monetary issues is the broader integration occurring in regional economic zones. The European Community, initially a common market that developed around a co-ordinated trade policy, is moving rapidly towards an internal market reform that will force a more common approach to the treatment of investment and stimulate further progress on monetary policy and fiscal co-ordination. The recently concluded Free Trade Agreement between the United States and Canada is far more than a trade accord, merging into cross-border investment policies that shape business conditions in an increasingly integrated market where monetary movements are already functionally linked.

10. Of special relevance for this increased linkage between macro-economic policies is the integrative role played by transnational corporations, which incorporate trade, investment and monetary dimensions in their daily operations. Organized through the vehicle of foreign direct investment, transnational corporations channel global private financial flows through their networks, either

ancillary to manufacturing operations or as part of the rapidly expanding realm of transnational corporation service enterprises. The major portion of world trade also flows within, between or among transnational corporations. Recent figures show that between 30 and 40 per cent of the trade of several major developed countries is intra-firm - that is, it occurs within a transnational corporation's affiliate network. After adding interfirm transactions, transnational corporations account for over three fourths of the countries' total international trade. 2/

2. Changing investment patterns

11. The average annual growth rate of world foreign direct investment outpaces both global merchandise exports and world economic output. Total world stock of foreign direct investment increased from $519 billion in 1980 to $1,023 billion by the end of 1987. 3/ Within this general expansion, significant changes are occurring in the national origin and destination of new foreign direct investment, thereby altering the make-up and distribution of the transnational corporation community. These trends foster accompanying changes in the traditional geo-political pattern of home and host country roles, particularly among the developed countries, laying the basis for similar alterations in their policy outlook on specific transnational corporation issues.

12. The United States, historically the world's top supplier of direct investment capital and home to the largest number of transnational corporations, has attracted progressively larger inflows of direct investment funds. 4/ As a result, that country now plays host to approximately as much direct investment from other countries as United States-based transnational corporations have invested abroad. Conversely, Western Europe has maintained, over the 1970s and 1980s, a roughly balanced position as both a supplier and recipient of foreign direct investment. The trend might now be affected by the recent pick-up of investments in Europe as corporations seek to position themselves in anticipation of the implementation of European Community internal market reforms in 1992. 5/ Investment patterns are shifting in Canada as well, long viewed as an atypical developed country in that it was concerned primarily with the policy problems of a host country. Canada's relative shares of the world stock of inward and outward direct investment had narrowed from 18.2 per cent and 3.3 per cent in 1962 to 8.5 per cent and 4.5 per cent in 1987, moving the region towards a position of greater balance between inward and outward direct investment. 6/

13. Japan is the major developed country that is now most dramatically out of balance in terms of a home/host country relationship. But Japan's role is still relatively new. The first major outflow of foreign direct investment from Japan began in the early 1970s and grew rapidly over the 1980s. Now Japan is also beginning to face greater inward direct investment. Policy pressures forced a lowering of barriers early in the 1980s, and transnational corporations from Europe and the United States are responding by seeking to establish a market position within the growing Japanese economy. 7/

14. These developments suggest a balancing trend among developed countries where cross-investments may create the basis for a more common policy outlook. The United States, especially, now grapples with issues of increased foreign ownership in its economy rather than promoting only home country positions. Meanwhile Japan already faces reciprocity demands, especially in the service sectors, that will limit its investment abroad unless a corresponding foreign investor presence is accepted there. 8/

15. The most persuasive explanation for this expanded cross-investment pattern is the greater parity that now exists between the world's developed regions. Corporations find they must be physically present in all areas in order to compete, particularly to stay abreast of new technological developments and to engage in a broad enough marketing campaign to recover the spiraling costs of research and development efforts. The forces of technological change have overtaken the widely accepted product life-cycle theory that explained much of the early foreign direct investment in manufacturing industries, especially those originating in the United States in the 1960s and into the 1970s. Now, competitive pressures from rapid technological innovation have compressed the theory's hypothesized time sequences to such a degree that the phased trade and investment decisions of the past are no longer possible. 9/

16. On the other hand, foreign investment to developing countries has stagnated, concentrating itself in a handful of relatively advanced industrializing countries. The developing world's share of direct investment stock dropped from over 30 per cent in 1967 to roughly a one quarter share in the 1970s and early 1980s. Well over three fourths of foreign direct investment flows in the 1980s moved among countries of the Organisation for Economic Co-operation and Development (OECD), while some 86 per cent of the remainder went to only 18 developing countries and territories. This uneven distribution is accounted for by the concentration of foreign direct investment in countries that have abundant natural resources, large domestic markets and/or abundant skilled but still relatively low-cost labour. While over one half of the total inward stock of foreign direct investment in developing countries is in the western hemisphere, the fastest annual growth rates occur in a few rapidly industrializing Asian countries. 10/

17. Technological change also accounts for some of the reduced attractiveness of many traditional host and other developing countries to foreign investors. Discoveries in new materials and processes lower demand for many of the raw materials traditionally supplied by developing countries. Automation and quality-control requirements make unskilled and semi-skilled labour a relatively less important component of manufacturing costs, decreasing the advantage of locating operations in labour-surplus countries. Few developing countries offer the range of knowledge-intensive skills or educational infrastructure necessary to compete as sites for information technology firms.

18. While losing these advantages on the production side, most developing countries also lack large enough internal markets to justify local production sites based on final sales figures. In fact, as cross-investment brings new threats to transnational corporation home markets, corporations concentrate their resources even further at home to battle foreign competitors for shares in major established markets, rather than exploring new market potential in the developing world.

19. This altered foreign direct investment pattern suggests the emergence of a technological convergence in the world's leading industrialized countries, and perhaps a small group of advanced developing or newly industrializing countries which are positioned to make similar progress. 11/ Among these countries, cross-investment trends will lead to more balanced policy positions between home and host country outlooks on foreign investment issues. The vast majority of other countries face an increasing gap between themselves and the industrialized countries, and the risk of being relegated on foreign investment issues to the position of an expectant but usually ignored suitor. While not dictating the flow of all foreign direct investment, the key factors of technological innovation, cross-investment competition and internal market size now appear to determine the location of new investment for traditional manufacturing transnational corporations as well as probably for service sector firms.

20. These competitive dynamics and their impact on geo-political alignments establish part of the environment for code discussions. Developed countries face a stronger imperative than in the mid 1970s to strengthen international co-operation on investment-related issues and their more balanced cross-investment positions may forge enough common ground to achieve positive results.

3. Changes in transnational corporations

21. In the mid to late 1970s, transnational corporations began a metamorphosis that both responds to and reinforces global macro-economic and technological change. Many of these changes are reflected in shifting aggregate investment trends but incorporated within the evolution of individual transnational corporation structures and operations. In several fundamental respects, the transnational corporation universe has also changed. Transnational corporations now come in all shapes and sizes from many different countries, supplying an evolving array of products and services through complex but fluid business arrangements. These changes diffuse power in many transnational business networks and weaken the ability of single national Governments to direct and control the full impact of transnational corporation activities.

(a) Changing numbers and sectors

22. Available statistics do not allow precise calculations, but some conclusions are possible with regard to the changes in the composition of transnational corporations. Some 600 firms are now part of a "billion dollar club" that generates roughly 20 per cent of total value-added in manufacturing and agriculture, although about 70 large transnational corporations account for one half of the sales. Twenty years ago, some 60 transnational corporations accounted for 50 per cent of the foreign direct investment total. Those figures have not changed much, but the composition of the club is now different. Corporations based outside the United States increased their representation among the top dozen or so firms in key product sectors, reflecting the diffusion of economic power and a more diversified competitive structure. The large number of small to medium-sized firms that invest abroad appear to move first into similar developed countries. These smaller transnational corporations appear to be growing in the degree of their

global involvement, while the ratio of foreign to domestic sales among larger transnational corporations has remained roughly the same. 12/

23. Several Eastern European countries, as well as China and the Soviet Union, additionally took historic steps to open their economies to a controlled inflow of foreign direct investment. In early 1989, nearly 200 joint ventures were reported in the USSR. 13/ But the number of joint ventures appears to be growing every day. According to recent estimates, by September 1989 more than 900 joint ventures had been registered in the USSR 14/ and by 1990 some 1,000 joint venture agreements are expected to have been signed. 15/ In Poland, the number of joint ventures registered by September 1989 are estimated to be about 1,330 (including some 800 "Polonia" firms), 16/ and in Hungary about 600. 17/ These actions suggest that group D countries will play a more active part in the consideration of foreign direct investment issues in future United Nations discussions and offer the possibility for expanded common ground to the extent that these countries act as both home and host locations.

24. The number of transnational corporations based in developing countries has increased also. But those enterprises come from a relatively small number of countries and are concentrated primarily in extraction and mineral-processing industries or in low-wage manufacturing sectors. Only a few transnational corporations from developing countries have individually penetrated developed market economies to establish an internal investment position.

25. The sectoral composition of transnational corporations based in developed countries has expanded into several new areas. Technological change brought advances in micro computers, robotics, fiber optics, and ceramics which alter the structure of some industrial patterns, while near-horizon developments in such fields as genetic engineering and super-conductivity promise to create whole new sectors of productive endeavors. Thus far, these industrial activities are concentrated in the advanced developed countries, in terms both of innovation and initial production, with developing countries playing a minor role unless they offer significant internal market potential.

26. Technological developments also stimulate the very rapid transnational corporation growth occurring in service sectors. Many services are not tradeable in the traditional sense, and both customer demands and the regulated nature of many service industries require a direct investment presence if a foreign enterprise is to participate in a country's domestic service economy. While service enterprises are expanding rapidly, particularly in the financial, trade and information-processing areas, those service activities are being conducted also by industrial transnational corporations which choose to internalize these functions. Overall, services now account for over one half of the annual flow of foreign direct investment and roughly 40 per cent of the stock (of which nearly half is represented by service activities carried out by industrial enterprises). 18/ This growth in services ties together a wider range of business activities, broadening the integrative effect of transnational corporations while also deepening the penetration of international economic forces into national economies.

(b) The growth of non-equity investments

27. One of the elements most commonly associated in the past with the concept of foreign investment was the equity stake taken by a foreign investor in a local business enterprise. Equity position has been assumed to reflect the level of foreign control over operational decisions and the distribution of resulting business profits. Hence, equity issues are central to the historical struggle by developing countries to increase their participation in local transnational corporation operations as well as to transnational corporation concerns over risk assessment and expropriation/compensation standards that help safeguard or assure recovery of their initial capital investment.

28. The series of reports from the United Nations Centre, Transnational Corporations in World Development, outline a progressively expanding range of low equity and non-equity operations undertaken by transnational corporations that can include turnkey or supply and plant leasing operations, management contracts, co-production and co-marketing, contract or subcontract manufacturing, franchising, licensing, and a range of associated joint ventures. 19/ Low equity or non-equity ventures often respond to host country political desires, but they are driven at least as much by marketplace judgements. While minimizing a transnational corporation's immediate financial risk that its sunken investment can be taken by a host country, lower capital operations also recognize that transnational corporation competitive advantages now often lie less in the provision of equity capital and more in technological applications, managerial know-how, and international market access that may not require overseas equity capital investments. Non-equity arrangements based on these advantages can also enhance a transnational corporation's flexibility to respond to changing global conditions - a valuable characteristic in times of rapid change in both products and production processes.

29. The increase in non-equity ventures has several important implications for assessing transnational corporation operations and the need for international corporate standards. A preliminary conclusion is that this development could provide further evidence for the erosion of traditional dividing lines between trade, investment and monetary issues. Some non-equity transnational corporation ventures resemble transaction-based trade or financial operations that are short-term and have limited impact on a host country's development. In such non-equity arrangements, the transnational corporation does not establish a continued investor relationship, but rather seeks short-term benefits. The host country buyer has greater control and independence in decision-making but cannot be assured of a continuing relationship or follow-up dealings with the foreign corporation.

30. On the other hand, transnational corporations can enter into non-equity arrangements from a long-term perspective, investing resources into the venture or integrating it into the transnational corporation's global network as fully as if equity capital were involved. In these cases, the venture partners will negotiate shared control arrangements in relation to the value of their resource contributions but with assessments made from a perspective that incorporates the project's expected generation of benefits over its full life span. Thus, the key element for

assessing how non-equity ventures relate to transnational corporation issues is probably the level of transnational corporation commitment to a venture over the longer term - a notion that was captured both conceptually and functionally by equity ownership at an earlier period.

31. This conclusion has important implications for the discussion of such transnational corporation issues as ownership, control and benefit distribution standards. A trade-off seems inevitable between the degree to which a transnational corporation exercises control over a venture and its willingness to make a substantial commitment to the long-term viability and profitability of the venture, whether or not the enterprise involves a direct foreign equity position. The growth of low equity and non-equity ventures may also offer developing countries certain new channels to tie into global markets, either linked to transnational corporation partners or exploring for themselves the potential for non-equity participation in other economies.

(c) The spread of mixed-nationality corporations

32. Another important development for the transnational corporation code debate and questions of international regulation, more generally, is a change in the national identification of transnational corporations. The earlier perceptions of a transnational corporation were that of an enterprise headquartered in a single home country. This perception is consistent with the early demand of the United States-based transnational corporations for wholly owned foreign subsidiaries. While the largest transnational corporations often seem exempted from pressures for local ownership participation, the proliferation of competitive transnational corporations has expanded the number of enterprises willing to engage in joint venture operations across national borders, even on a minority ownership basis.

33. More recently, transnational business competition and technological developments have created cost and marketing pressures that force even the largest transnational corporations to adapt their organizational structure and management operations. These changes are reflected in the growth of intercorporate alliances, often between competing enterprises, that encompass a growing variety of transnational business arrangements, including the full range of non-equity ventures. While many of these arrangements were used in the past, their rapid expansion in key industries and importance to overall corporate strategy alter the nature and application of managerial control and reduce the relative importance of traditional equity-ownership-related measures.

34. Intercorporate arrangements among transnational corporations in the industrialized world reach across broad industrial sectors. Hundreds of joint ventures and collaboration arrangements exist in the oligopolistic automotive industry, where the nationality associated with famous corporate nameplates now bear little necessary relationship to the identity or location of the product's value-added activities. For example, an automobile model that recently made headlines as the hottest selling import in Japan is manufactured in the United States by a Japanese company that is itself nearly one quarter owned by a United States company. In telecommunications, a French/United States/Belgian telecommunications venture battled a United States/Dutch/Italian alliance over

increased sales in the Federal Republic of Germany market, while a major Japanese communications company placed its first overseas order for telecommunications equipment from the North Carolina facility of a Canadian firm.

35. Although this phenomenon is not widespread, the mixed national character of many transnational corporations provides an increasingly pluralistic backdrop for political discussions on international economic issues. Corporate executives attempt both to influence and outguess governmental readjustments to rule-of-origin definitions in light of "Europe 1992" proposals and the United States/Canada Free Trade Agreement. In debate over extending the voluntary restraint agreement that protects the United States steel industry, 34 members of California's congressional delegation support a bid for increased semi-finished steel imports deemed essential by California Steel Industries, "a major state business" jointly owned by Brazilian and Japanese steel companies whose imports come largely from related new extraction and production facilities in Brazil. 20/ Many United States corporations even view the development-oriented Generalized System of Preferences as critical to their competitiveness, arguing that excluding some newly industrializing countries would raise component import costs by tens of billions of dollars.

B. Impact of change on the United Nations code

1. Need for the code

36. Developments over the past two decades have enlarged the role of transnational corporations in the international system while in the process altering the transnational corporation universe. Both these impacts, and the interactive relationship between them, need to be assessed in relation to the rationale and prospects for a code on transnational corporations. Are past motivating factors still relevant; are code discussions in the United Nations directed at appropriate political and economic objectives; more specifically, are these entities, their activities and their impact important enough to warrant a framework; and are these activities sufficiently international that they require an international régime?

37. Transnational corporations are fast becoming the lynchpin for world economic activity, particularly in the most dynamic sectors of information-based technology and services. Transnational corporations act as a vehicle for organizing and integrating trade, investment and monetary transactions across national borders. Technological advances allow, and competitive pressures require, that enterprises "go global".

38. Although this change is by no means on a large scale, it has two important implications for the code debate's rationale. First, interdependent and integrating economic forces require an overview comprehensive enough to match the global span of transnational economic processes and impacts. Questions of international economic policy are now beginning to be treated more as a unified whole than in separated compartmentalized policy segments divided according to trade, investment and monetary issues. Transnational corporations, as the major organizational vehicle of this integration, are a central part of such policy considerations. This reinforces the need for an international framework that addresses the activities of these corporations.

39. Secondly, there is urgent need to address the emerging economic and geo-political pattern that threatens to split the world into two isolated economic blocs. Without conscious policy steps to encourage economic linkages between developed and developing countries, the large majority of the world's population will be consigned to a politically unstable and ethically unacceptable state of permanent "underdevelopment". Again transnational corporations, as the primary vehicle for functional economic integration, can play a constructive linking role, if guided within an appropriate international framework. To be fully effective, such a framework would have to address both governmental and private sector responsibilities in the international economic system, a principle that is already in the United Nations code.

40. Finally, many of the challenging new problems emerging in the international arena are truly transnational in character, both in terms of their impact and the manner in which they must be managed. An obvious example is protection of the environment, which is not divisible territorially since pollution of the air or oceans can quickly spread beyond political boundaries, requiring a co-operative international approach. Worker and product health, safety and quality standards raise other common international issues, especially since products and services are rapidly and widely dispersed through an increasingly interdependent transnational network.

41. While the control of potentially negative impacts is a concern, the facilitation of positive benefits is equally important. A supportive international framework is necessary for the continued liberalization of national foreign direct investment régimes, growth of global stock markets and securities exchanges, linked data processing services and media transmission facilities. Similarly, the protection of intellectual property rights, stability of component supply networks, and establishment of efficient and effective global marketing and franchising systems require compatible governmental approaches to regulatory goals and enforcement. These developments need co-ordinated definitions and regulatory processes that facilitate rather than impede business transactions.

2. Outstanding issues

42. In order for the code to fulfil all these important functions, the present impasse in the code negotiations will have to be broken. This might be possible by an application of political will that minimizes the debate over formulations of principles rooted in past controversies, focusing instead on the code's co-operative objectives, in the light of new geo-political developments and economic realities.

43. Among the concerns that stimulated the United Nations to undertake the code exercise in the early to mid 1970s were fears about potential transnational corporation interference in domestic political affairs, especially where corporations could draw on their home Government's political support, or indeed perhaps operated at that Government's behest as an arm of its foreign policy. Although developed countries are host to the vast majority of foreign direct investment, they generally feel less vulnerable to this type of outside pressure, so the issue was framed primarily in a North/South context.

44. In an applied sense, diffusing the political antagonisms surrounding transnational corporation issues has important implications for most of the unresolved issues in the United Nations code debate. For example, non-interference by transnational corporations in internal political affairs was a contentious topic early in the debate. Home Governments can now endorse the principle of non-interference without seeming thereby to accept allegations of widespread transnational corporation misconduct. In fact, the non-interference principle is now finally accepted by all sides in the code discussions, reducing this once burning political issue to a manageable debate over appropriate formulation.

45. The code discussions on the outstanding issues are often locked into a debate that no longer corresponds to the altered political and economic reality of transnational corporation operations. Innovative risk-sharing measures and conflict resolution procedures provide ways to manage problems associated with transnational corporation operations, but these practical changes have not yet carried over into the code discussions. The deadlocked debate over expropriation/compensation and a reference to international law or obligations is another excellent example in this respect. Even if the dramatic reduction of expropriation incidents during the 1980s may only be prima facie evidence of the decreasing importance of this controversy, more convincing are developments that appear to account for the declining expropriation figures, including both corporate techniques to reduce, manage or offset potential expropriation risks, and changing governmental practices that decrease the attractiveness or need for expropriation actions.

46. Corporations have increased their use of reduced and non-equity investments since the early 1970s, thereby decreasing their exposure to expropriation. Joint ventures, project finance, turnkey operations, and management contracting are among the techniques mentioned earlier that enable transnational corporations to share the burden of raising capital for new projects as well as spread the risk of subsequent losses. Additional progress is evident on bilateral and multilateral mechanisms to insure or otherwise guarantee against expropriation of investment capital.

47. Actions on the governmental side also push the significance of the expropriation/compensation debate further and further from meaningful reality. The historically central stake for developing countries in this issue was to reassert their permanent sovereignty over natural resources. National sovereignty is now an accepted fact, not an objective. Dealings with transnational corporations are pursued in the context of more equal bargaining over the market terms of a contract. Indeed, the initial emphasis on local ownership as the embodiment of national control over an investment is now a less important objective for many countries, which may aim instead at capturing a larger share of the economic benefits that derive from a transnational corporation's non-equity competitive advantages.

3. Application of the code objectives to contemporary transnational corporations

48. The broad objectives for a United Nations code of conduct on transnational corporations have been described as follows:

> "The United Nations code of conduct on transnational corporations is meant to provide a stable, predictable and transparent framework that would facilitate the flow of resources across national boundaries and thereby enhance the role of foreign investments in economic and industrial growth. At the same time, the code is meant to minimize any negative effects associated with the activities of transnational corporations." 21/

49. This goal - to maximize the positive and minimize the negative - is still essentially valid and unobjectionable. Applying these objectives to the contemporary cast of transnational corporations, however, requires intensified efforts to match code concepts and transnational corporation structures. The types of transnational corporation changes outlined in the chapter above point to a rather qualitative mix incapsulated in the overall concept of a transnational corporation. The key to addressing the mixed range of contemporary transnational corporations with a code lies in stressing the code's functional approach, based on an understanding of their actions and impact. The fact that the code definitional criteria rely on operational factors more than equity characteristics constitutes an important built-in advantage.

50. The conceptualization of policies on transnational corporations within the code framework might therefore need to take into account these changes in a parallel fashion, to match the evolved and expanded group of enterprises that now crowd under the common umbrella label of "transnational corporation". In policy terms, these changes could mean that:

(a) The locus of effective responsibility for, or effective control over, many important international business operations is becoming more difficult to ascertain;

(b) A transnational corporation's overall commitment to a particular product line, stage of production, or geographical location is less stable over time, since less of a transnational corporation's own capital is directly invested and fewer business functions are internally integrated.

51. If these policies focus primarily on traditional transnational corporation types, or rely on the unilateral actions of national Governments, it will fail when applied to emerging international issues that arise from the growing range of interdependent business arrangements among transnational corporations from different countries. Thus, Governments might need to be prepared to adjust their responses in order effectively to address complex business structures and processes. This step does not require a redrafting of current definitions but the application of the code concepts to the types of transnational corporation-related issues that would need to be addressed currently and in the future.

52. It would be important, therefore, first to assess how the code concepts apply to issues affected by changing international business relationships that weaken central transnational corporation control mechanisms while dispersing both authority and responsibility. More transnational corporation activities are interlinked across national boundaries in ways that leave them not fully under the control of a single corporate office against whom national regulations can be applied. Attempts to apply national regulations to the full array of intercorporate partners in a global network would raise extra-territorial jurisdiction issues even more divisive than in the past. This change then places a higher premium than before on forging a broad international framework for managing such potential political difficulties. The objective should now be at least as important for home country Governments as for hosts, since formal control over the parent headquarters no longer guarantees effective control over the range of business dealings in which that transnational corporation may be involved.

53. A second major implication of this change relates to the notion of transnational corporation commitment and corporate responsibility. As transnational corporations emphasize non-equity investments and explore flexible arrangements among multiple business partners, a transnational corporation's long-term stake in any specific host location might be thereby reduced. A challenge for the code's follow-up discussions will be to account for this change in the consideration of ownership and control issues, while exploring ways to enhance transnational corporation stakes in the economic growth and social vitality of developing country regions, including business arrangements that can tie these areas more effectively into the global market system.

4. Emerging transnational corporation issues

54. An interactive dynamic exists, therefore, between changing transnational corporation characteristics and policy concerns associated with transnational corporation activities and influence. The policy issues raised by current transnational corporation operations may need to be assessed in order to determine how best to apply code standards to appropriate types of transnational corporation-related issues and to identify new concerns that may arise from evolving transnational corporation structures, functions, and sectoral concentrations. The essence of a code for transnational corporations revolves around identifying and addressing those issues that are particularly applicable to enterprises conducting transnational operations, even though the standards may also reflect good practice where relevant for local firms as well. Changes in macro-economic and geo-political factors, along with sectoral investment shifts and the metamorphosis of transnational corporation organizations, alter the mix of issues significant to transnational corporation discussions within the code framework. In some cases the application and outlook of traditional issues are transformed, while in other instances new or expanded topics arise to claim higher priority attention. A sampling of examples will indicate the possible impact of changing conditions on the context for future transnational corporation discussions and the possibilities they offer for renewed interest in the code.

55. New priority attention in the code's follow-up discussion might be due to matters such as the indirect employment impacts of transnational business networks, particularly their linkage function between developing and developed country markets. Transnational distribution and marketing operations can indirectly enhance employment objectives in developing countries by providing a channel for those countries' exports to the developed economies. Without ties to transnational corporation networks, preferably through long-term subcontracting or contracting commitments, the breadth and depth of these increasingly integrated markets may otherwise exceed the resources of most developing country exporters.

56. Cross-investments by transnational corporations located in the major developed markets reinforce interdependent ties between these regions, deepening both economic and political stakes in establishing co-operative multilateral relationships among governmental entities. Lacking a similarly balanced cross-investment position running north to south between developed and developing countries, the danger is that these regions will pull further apart. The challenge will be to encourage market linkage developments arising from the recent metamorphosis of transnational corporation structures in a way that supports North/South political as well as economic relations.

57. The role of transnational corporations in the international expansion of service sector industries is another development that raises new issues for the future transnational corporation discussions within the code framework. Service industries are among the most heavily regulated sectors within any national economy, providing fertile ground for international conflicts over the approach and application of national regulatory schemes. One reason for such extensive regulation of services is the extent to which these activities penetrate a country's economic and social fabric, touching the daily lives of individual citizens. Intangible flows of information, skills and financial resources, the assets upon which service sector competitiveness depends, cannot be kept as conceptually or practically segregated in a country's economy as the production of physical goods.

58. Service sector transnational corporations that introduce a "foreign" element into these domestic processes may thus raise a set of future political issues that are potentially more sensitive and challenging for international co-operation than traditional controversies over natural resource ownership or wage-rate exploitation. While transnational corporations provide the building blocks that allow for a dynamic and globally interdependent services network, a new level of international co-operation and co-ordination will be necessary to sustain the benefits of global integration in the face of nationalistic fears and pressures for restrictive unilateral regulation and control. Additionally, many provisions already agreed to in the draft text of the code are beneficial and directly relevant to discussions on trade in services and trade-related investment measures which are under way in the GATT-sponsored Uruguay Round of trade negotiations.

59. A possible extension of this activity would be to encourage further co-operation among transnational corporations and Governments in improving regulatory co-ordination in the international financial sector. In light of recent stock market events, co-operation appears especially imperative among the world's

nationally organized but functionally interdependent securities and commodities markets. International standards and co-ordination would help manage potentially destabilizing spillover effects while enhancing the efficiency and ensuring the integrity of market procedures. These efforts could lead to appropriate international standards of accounting, auditing and registration; promote better dissemination of information; and create international prohibitions against fraudulent conduct such as insider trading and market manipulation. Moreover, further steps might need to be taken to facilitate developing country access to established securities markets, while assisting in the mobilization of their own financial resources. These steps could lay the basis for the progressive incorporation of emerging markets into an internationally co-ordinated network that could exploit the efficiency of increased interdependence while minimizing the costs and risks involved in international financial transactions.

60. Recent efforts in the Uruguay Round of multilateral trade negotiations towards dismantling governmental measures that represent barriers to international trade, under the overall notion of trade-related investment measures and trade-related intellectual property measures, have also underscored the importance of certain restrictive business practices by transnational corporations, such as transfer pricing and restrictive business practices, as having potentially more distorting effects on international trade. The provisions of the code dealing with these issues could provide a basis for developing specific norms and procedures aimed at avoiding the negative effects of such practices.

61. Other business sectors offer similar opportunities to promote a framework that can sustain the further expansion of integrated world commerce, helping to bridge the gaps between economic regions. Many types of subcontracting arrangements can promote the beneficial integration of business across national boundaries, provided that the international community can co-operate to minimize unnecessarily restrictive governmental policies. Improved technology also now allows for communications systems that tie developing countries into transnational data processing networks, facilitating the transfer of information as well as providing improved job skills and opportunities.

62. The growth and interdependence of transnational business also creates a need for international attention to environmental and health issues that mutually affect business and governmental interests throughout the world. Similar international problems are now emerging in product-related health, safety, and quality standards due to the rapid increase and interdependence of world commerce. For example, in an integrated trading system, the incorporation of sub-standard counterfeit goods in manufactured products or residue pesticide levels in agricultural produce generate safety and reliability concerns among global consumers. Internationally agreed upon standards and procedures are necessary to avert difficulties that stem from the application of varying national criteria, laws, and regulations.

63. The safe and effective disposal of hazardous waste is another issue that is beginning to receive concerted world attention. The opportunity exists for co-operation between transnational corporations and Governments in planning for future storage and disposal needs, the prevention of accidents and/or leakages, and an overall reduction in hazardous waste products. Over recent years a number of

serious incidents involving toxic chemicals, radioactive material, and oil spills have forewarned the world community that risks from deficient environmental or safety standards fall not just locally but also regionally and even globally. A new initiative by the United Nations Centre on Transnational Corporations illustrates how the development of international guidelines and co-operative follow-up activities might be used in response to environmental issues. The Centre is exploring the formulation of criteria and principles that corporations could use in planning and managing their international operations, pursuing this exercise in a manner that addresses both public policy concerns and private business interests. Corresponding activities include determining the feasibility of a fund, financed by voluntary transnational corporation contributions, to support environmental preservation. Such efforts highlight the feasibility of a consolidated international framework, utilizing both private and public sector resources and input, from which to launch co-operative endeavors addressing global issues.

64. As with other issues that relate to the impact of international business developments, this new activity of the Centre points the way towards a code framework for co-operation among Governments, complemented by the active advice and assistance of transnational corporations, which could maximize recognized benefits of transnational business activities while preventing or minimizing potentially negative effects. The extent of the exercise's success, as well as potential progress on other new transnational corporation agenda issues, will depend in large measure on whether the general debate on the code can move from the past to the present. From this prespective, the code negotiations could look forward to a code that will be able to examine and encourage international discussion on emerging issues, rather than being relegated to mediating old disputes where participants are already locked into rigid ideological positions.

III. THE CODE OF CONDUCT AND THE URUGUAY ROUND

A. Interrelationships

65. It seems likely that the code will be successfully negotiated, despite previous difficulties. One reason for such a possibility is that many of the issues involved in the Uruguay Round of multinational trade negotiations have, in fact, been for years under negotiation in the code exercise, and some degree of consensus has been reached on them. The interweaving of trade and investment questions - so substantially demonstrated over the course of the past years - has been such that many of the features of a "level playing field" are in fact dealt with in the code negotiations. The Montreal Ministerial Declaration, for example, calls for further identification of the trade restrictive and distorting effects of investment measures that are or may be covered by existing articles of the General Agreement on Tariffs and Trade (GATT) and other investment measures that may not be covered adequately in existing GATT articles but are relevant to the mandate of the Group of Negotiators given by the Punta del Este Ministerial Declaration; the Group is also directed to consider development aspects that would require attention. 22/

66. Given the work of the Commission on Transnational Corporations, it would seem that these tasks could be advanced by consideration of the rather substantial achievements on investment measures which are contained in the current draft code. It may well be that the language of the articles so far more or less agreed in the code might be adjusted. But their relevance, and the relevance of the work done in achieving a rather substantial amount of consensus, to Uruguay Round objectives, is clear. Clauses having to do with national treatment, with balance between the interests of developing countries and of developed countries in investment matters, are surely fundamental to fair trade practice, especially in the light of present and increasingly growing internationalization of investment and of international investment as integral to world trade.

67. The code, even in its present incomplete form, might be useful to the elaboration of provisions regulating trade where, as in services, right of establishment is important. The code has the flavour of the environment in which it has been negotiated - that is, it reflects something of the concern of developing countries about unrestricted entry of foreign investment. The right to determine which investment may enter a country has traditionally been cherished as an inherent right of sovereignty. (This does not, of course, prevent that right from being bargained away to a greater or lesser extent - the right to make such a bargain being also an inherent aspect of sovereignty.) Developing countries have in the past worried greatly about control of their economies through foreign investment. That fear is not confined to developing countries alone. It is likely that, whether or not explicitly acknowledged in an understanding on trade in services, some aspects of the flavour of the code regarding right of entry will be reflected, whether by the listing of restricted industries, percentages of foreign investment, reporting requirements, or otherwise.

68. Thus, the provisions of the code on transnational corporations, and government conduct could, in many instances, be replicated in Uruguay Round conclusions. In this sense, the old concept of a "GATT for investment" - which, when proposed, seemed impractical to many observers mainly because fundamental principles had not been worked out or even openly debated - has now acquired a new vitality. This lends importance to ongoing discussions on the code and on the substance of its provisions, both in the context of the Commission on Transnational Corporations and in the debates centered on the Uruguay Round.

B. Trade in services and the code

69. The Uruguay Round of trade negotiations, now approaching its end, should thus produce renewed interest in the code, as well as in other efforts towards standards of conduct for, and treatment of, the foreign affiliates of transnational corporations. Code efforts have a considerable relevance, especially in the area (of great prominence in the Uruguay Round) of trade in services. 23/ Much foreign trade leads to foreign investment, in the natural evolution from "mere" trade to the establishment of operations in the country of destination of goods that are essential for the promotion of sales or the servicing of such goods. Where services are the "commodities" being traded, it is almost always necessary to have some sort of establishment (or investment) in the country in which such services

are consumed, it being the nature of services that they are produced and consumed in the country of destination. Since the topic here is "trade in services", there is a tendency to emphasize the trans-border aspects. But in most cases, in large industries, trade in services involves a foreign investment aspect. It also may involve immigration issues, as is, again, illustrated in the Canadian/United States Free Trade Agreement.

70. Where obstacles to trade in services exist, they generally take the form of regulation within the country of destination - not, as is more often the case with goods, at the border. In respect of trade in goods, most-favoured-nation treatment is the fundamental principle, with national treatment being important but in many respects secondary. The situation is different in respect of trade in services. In that situation, regulation is both internal and directed towards the supplier of the services. Regulations are directed towards branch banks, insurance companies, travel agencies, or the like - that is, towards entities established in the country of destination. Thus, the national treatment provisions of the several investment codes, whether they be the United Nations code, the OECD Declaration or even the bilateral agreements, such as bilateral investment treaties, become central to an understanding, within the Uruguay Round, on trade in services.

71. The OECD Declaration, for example, provides that Member States should, "consistent with their needs to protect their essential security interests and to fulfil commitments", accord national treatment to "foreign-controlled enterprises". 24/ The United Nations code, after stating the obvious right to control entry, goes on to provide fair and equitable treatment. This (despite the problem of defining exactly what constitutes such treatment) is an absolute standard, and, from the point of view of the trader-investor, a considerable advance on the purely comparative standard of national treatment (or, for that matter, most-favoured-nation treatment). In other words, even if the State in question acts unfairly towards its own investors, the provision requires fair treatment for the foreign investor. The United Nations draft code also includes the national treatment standard: "Subject to national requirements for maintaining public order ... entities of transnational corporations should be given treatment accorded to domestic enterprises in similar situations". 25/

72. In other respects relevant to trade in services standards, the United Nations draft code is arguably more aposite than the OECD Declaration and Guidelines. For a heavily regulated industry (as are most service industries) transparency with respect to governmental regulation is important. It is useful, for example, for a supplier of transport or communications services to know as much as possible about proposed new regulations and to be able to present a point of view in regard to such proposed regulations.

73. Transparency is in fact an important aspect of the OECD Guidelines; but the Guidelines are applicable to enterprises, not to States. They do not suggest that members (States) should open up the process of considering and issuing new regulations. In contrast, the United Nations draft code stresses "the importance of endeavouring to assure the clarity and stability of national policies, laws, regulations and established administrative practices". It also encourages the dissemination of "relevant information concerning decisions of competent

administrative bodies". 26/ There is of course great importance in publishing and making readily and widely available regulations which have been promulgated; the issue of the extent to which the process of arriving at such regulations should be "transparent" is a more complicated one, though it may be of equal, or, in some cases, greater importance.

74. These latter provisions are of more than slight importance to the service industries. Services, as noted, tend to be heavily surrounded by networks of regulatory standards, many of which are ambiguously phrased and often depend for their effect on obscure interpretations. Administrative decisions and interpretations are likely to be as - if not more - important, than the published regulations, in themselves often far from models of clarity. Publication of interpretations is not often a priority matter, and even finding the text of such interpretations is often difficult. The advances made by the draft United Nations code towards transparency are therefore not to be lightly discarded.

75. The useful provisions of the United Nations code should not be lost because of difficulty in reaching agreement on, for example, the standard of compensation upon nationalization. Investment disputes have been largely solved despite different theoretical preferences. The measure of compensation to be used in cases of expropriation has been found to be an issue capable of agreed compromise in many a settlement. Those are no longer matters that should frustrate agreement on the many rules of fair play which are present in the provisions of the code already accepted.

76. Moreover, the network of bilateral and multilateral agreements now in place and, even more, the intricate interlacing of economic interdependence which now exists argues that solutions will be found in the future probably more easily than in the past. These unsettled issues should not strip the international economic negotiations of the values found in a document like the United Nations code.

77. Finally, it is important that that code has been negotiated, over the course of all too many years, with the full participation of the developing countries. Concepts such as the Generalized System of Preferences and part IV of GATT do not amount to an international trade agreement that affirmatively contributes to their development. The area of services trade is one of remaining fields in which there is an opportunity to attain something like equality.

IV. PROSPECTS FOR AN EARLY CONCLUSION OF THE CODE

78. The growing significance of transnational corporations in the world economy increases the importance of concluding an international framework that would promote and guide essential functions performed by those corporations, particularly in mobilizing the capital, skills and technological resources required to meet world growth and development needs.

79. Global economic and political relations have changed over the past two decades, altering as well the manner in which transnational corporations conduct their operations. Increasingly interdependent movements of international trade,

investment and finance have restructured international economic relations. Government interests have evolved, influenced by the rate and pattern of economic development, regional interests, and emerging issues of common global concern. While ever more important, transnational corporations themselves also have changed. The cast of contemporary transnational corporations differs significantly from that of their predecessors in number and variety of sizes and countries of origin as well as in more qualitative aspects of operational control and managerial decision-making.

80. These changes reshape many of the determinative factors in the debate over transnational corporations. Original motivations and perceptions might no longer apply in the same way, particularly with the decline in political antagonisms over specific transnational corporation conduct. New and more systemic needs have arisen related to the evolving nature of transnational business and its impact on an increasingly integrated global economic network.

81. Newly evolving transnational arrangements appear to place a single nation's sovereignty more effectively at bay than did the unitary enterprises that existed when studies on transnational corporations first emerged. Elements of sovereignty are not being passed to some new international actor, however, but rather forfeited to a transnational economic process that needs a similar level of transnational policy response if public interests are to be served effectively. The draft code of conduct on transnational corporations provides the appropriate framework to deal effectively with new policy concerns and issues. Conceptually, the code reflects a dual structure, recognizing that the global economy operates through the collective interaction of Governments and the private sector. Follow-up actions under this code concept would seek a co-operative commitment to explore the means and methods for dealing with the political as well as economic dimensions of global transnational corporation issues.

82. As interests and issues change, the effectiveness of proposed responses calls for reassessment. But in order to address the challenges arising in the evolving international system, negotiations on the code of conduct must first be freed from early controversies; the validity of old disagreements need to be re-examined, and the direction for mutually beneficial new steps established. With a renewed political commitment, Governments can dismantle negotiating barriers that are now more symbol than substance, breaking the impasse that has held the United Nations code discussion for nearly a decade. Compromises are possible along the lines recently suggested by groups of experts.

83. A code agreement resulting from renewed efforts would mark a significant transition from conflict to co-operation. World development needs are too great and the potential contributions of transnational corporations too important to allow outdated antagonisms to block essential progress. Macro-economic trends and transnational business operations multiply integrative links between nations, but this development is neither evenly distributed nor irreversible. Without appropriate guidance from the international community, commercial processes may leave a backwater of underdevelopment that is politically and ethically unacceptable. Newly resurgent neo-mercantilism, whether manifested nationally or regionally, can threaten global ties, as can public policies based upon misconceived

or misapplied concepts regarding private enterprises. An international framework covering the conduct and impact of transnational business as well as government treatment of transnational corporations would help minimize friction and conflict while encouraging beneficial economic growth. The code would provide a stable multilateral framework and a platform from which to launch follow-up initiatives, combining public and private sector resources in pursuit of renewed growth and development.

84. Meanwhile, movement continues on co-operative, issue-specific agreements that address a range of international problems in a variety of multilateral forums. But unless a global comprehensive framework on foreign direct investment is adopted, more cohesive regional collections of countries will continue to deal with the issues that most concern them. The danger with this piecemeal approach is that it excludes some affected parties and ignores the ultimate political implications of such actions. If the world community possesses no vision of the future, activity will be defined by the pressures of the present, and those pressures are drawing nations into regional economic blocs that threaten increased political confrontations, especially along a North/South divide.

Notes

1/ The New Code Environment. Current Studies, Series A (United Nations publication, forthcoming).

2/ International Direct Investment: Global Trends and the U.S. Role. 1988 edit. (Washington, D.C., International Trade Administration, United States Department of Commerce, November 1988), p. 1; and Transnational Corporations in World Development: Trends and Prospects (United Nations publication, Sales No. E.88.II.A.7 and Corr.1).

3/ United States Department of Commerce, International Trade Administration Direct Investment Update: Trends in International Direct Investment. Staff Report (Washington, D.C., September 1989).

4/ Foreign Direct Investment, the Service Sector and International Banking. Current Studies, Series A, No. 7 (United Nations publication, Sales No. E.87.II.A.15), p. 5.

5/ United States Department of Commerce, Survey of Current Business (Washington, D.C., August 1989), p. 69. (Adjusted for the Netherlands Antilles' finance (except banking), insurance and real estate section.)

6/ "Recent developments related to transnational corporations and international economic relations: report of the Secretary General" (E/C.10/1989/2), 25 January 1989, pp. 14-18.

7/ International Direct Investment, op. cit., p. 77; and Amy Borrus, "Slowly but surely, the United States is buying into Japan", Business Week, (19 December 1988).

Notes (continued)

8/ For example, the Primary Dealers subtitle of the United States Omnibus Trade and Competitiveness Act of 1988 used reciprocity demands to force an opening of Japan's bond market to foreign firms. See also Monica Langley, "Trade bill conferees agree on limits for foreign dealers in U.S. securities" The Wall Street Journal (31 March 1988); and Michael Sesit and J. Terence Gallagher, "Japan unveils new measures to widen foreign role in government bond mart" (7 September 1988).

9/ Transnational Corporations ..., op. cit., p. 57; and Raymond Vernon, "The product life cycle in a new international environment", in The Contemporary International Economy, John Adams, ed. (New York, St. Martins Press, 1985), pp. 408-422.

10/ Transnational Corporations ..., op. cit., p. 80.

11/ The "convergence club" idea is adopted in application from the concept outlined in Technology and the American Economic Transition: Choices for the Future, Office of Technology Assessment, Congress of the United States (Washington, D.C., May 1988), p. 287.

12/ Transnational Corporations ..., op. cit., pp. 33-40.

13/ Information provided by the Ministry of Finance, USSR.

14/ Ibid.

15/ Ibid.

16/ Information provided by the Foreign Investment Authority of Poland.

17/ "JVs, investments, Hungary-US Ties", Daily News (London) (27 June 1989).

18/ Ibid., p. 1; and Transnational Corporations ..., op. cit., pp. 4-5.

19/ Transnational Corporations ..., op. cit., pp. 67-71.

20/ "Congressional delegations battle over firm's attempt to raise steel imports", Inside U.S. Trade (9 June 1989), pp. 14-15.

21/ The United Nations Code of Conduct. Current Studies, Series A, No. 4 (United Nations publication, Sales No. E 86.II.A.15), p. 2.

22/ See "The Punta del Este Ministerial Declaration, part II: negotiations on trade in services", GATT Focus (8 October 1986).

Notes (continued)

23/ For a detailed discussion on the relevance of the code provisions to the negotiations on an international régime on trade in services, see Key Concepts in International Investment Arrangements and Their Relevance to Negotiations on International Transactions in Services. Current Studies, Series A, No. 13 (United Nations publication, forthcoming).

24/ OECD, International Investment and Multinational Enterprises: Declaration by the Governments of the OECD Member Countries, 21 June 1976 (Paris, 1976).

25/ See proposed text of the draft code of conduct on transnational corporations (E/1988/39, Add.1, annex), para. 52.

26/ Ibid., para. 53.

Annex

REPORT ON THE HAGUE SYMPOSIUM ON THE UNITED NATIONS CODE OF CONDUCT ON TRANSNATIONAL CORPORATIONS

15-16 SEPTEMBER 1989

Under the sponsorship of the International Law Association's Committee on the Legal Aspects of the New International Economic Order and of the United Nations Centre on Transnational Corporations, a group of prominent international lawyers from diverse national and juristic backgrounds participated in a symposium on the current status of the draft United Nations code of conduct on transnational corporations. The focus of attention was on the outstanding issues in the negotiations for the code of conduct, although the participants also addressed the need for such a code and the prospects for its finalization.

Need for the code

The participants endorsed the validity of the code exercise in the contemporary international economic environment. They felt that the code was still as critical as it had been at the inception of the negotiations some 13 years ago. Current international developments, such as the increased internationalization of economic activities, the phenomenal growth in the volume of trade and foreign direct investment flows, the emergence of services as an important component of foreign direct investment and trade, and indeed the entire phenomenon of increasing interdependence in the world economy, all underscored the importance of transnational corporations as major actors in the world economy. Those trends reinforced the need for an international framework for the operations of transnational corporations.

Outstanding issues

It was agreed that the outstanding issues in the code of conduct had important implications for international law, and the principal objective of the symposium was to invite distinguished and experienced international lawyers to review those issues, the divergent positions of the negotiating parties and the various formulations with a view to making an overall assessment as to whether the basic approach of the Commission on Transnational Corporations in the formulation of the various provisions was feasible or otherwise flawed on technical grounds. The outstanding issues in that regard were:

(a) The question of a reference to international law/international obligations;

(b) Non-interference in national political affairs;

(c) Respect for national sovereignty;

(d) Nationalization and compensation;

(e) Dispute settlement;

(f) National treatment.

The participants found no fundamental technical flaw in the basic approach of the Commission as to the outstanding issues. While some of the formulations could be refined or improved upon, the essential format of the provisions on the outstanding issues was considered feasible. If there was any impediment to the conclusion of the code, it derived from the lack of political commitment of the negotiating parties to the code and not the technical defects of the formulations. Conversely, flawless drafting could not by itself assure finalization of the code if the political will of the member countries was non-existent.

As to the specific outstanding issues, the general sense of the symposium was as follows:

1. The question of a reference to international law/international obligations

The importance of stipulating a reference to "international law" or "international obligations" in the code was underscored, although it was recognized that such a provision need not elaborate the substantive content of such law. After reviewing the debate on the doctrinal implications of referring to international law or international obligations, it was pointed out that for the purposes of the code, the distinction between international law and international obligations was not essential. That was because obligations of States with respect to foreign investment did not merely include obligations founded on conventional law but also obligations derived from customary international law. On the other hand, a State's obligations under international law must necessarily encompass its conventional as well as its customary legal obligations.

The discussion on the issue revolved around the text of paragraph 49 of the Chairman's draft, viz.:

> "In all matters relating to the code, States shall fulfil, in good faith, their international obligations, including generally recognized and accepted international legal rules and principles."

It was suggested that the words "and accepted" in the context of that provision departed from the established phraseology in connection with the validity of international legal rules and principles, and should accordingly be deleted. It would be enough to retain the phrase "generally recognized" which had a clear technical connotation. With a further amendment, which was purely editorial, paragraph 49 should read as follows:

> "In all matters relating to the code, States shall fulfil, in good faith, their international obligations, including those arising from generally recognised international legal rules and principles."

The amended text commanded general support, but other alternative formulations were suggested, namely:

"In all matters relating to the code States shall fulfil, in good faith, their obligations under international law."

and

"In all matters relating to the code, States shall fulfil, in good faith, their international obligations".

With regard to those formulations, it was pointed out that the terms "international obligations" or "obligations under international law" should not be construed as implying the internationalization of all obligations, such as obligations arising under contracts between States and transnational corporations.

2. Non-interference in internal political affairs

The importance of prohibiting transnational corporation interference in the national affairs of host States was acknowledged. A question was raised as to whether the concept of non-interference was feasible since it could imply severe limitations on normal business relations between a transnational corporation and its host State. However, it was the overwhelming sense of the symposium that the formulations of the code - namely, paragraphs 16 and 17 of the Chairman's draft - accommodated any legitimate corporate activities in the host State and were broad enough to encompass the divergent policies and practices of host countries in that regard.

The said paragraphs 16 and 17 read as follows:

"16. Transnational corporations shall not interfere in the internal affairs of host countries, without prejudice to their participation in activities that are permitted by the laws, regulations or established administrative practices of host countries."

"17. Transnational corporations shall not engage in activities of a political nature which are not permitted by the laws or established policies and administrative practices of the countries in which they operate."

It was felt that the above provisions captured the essence of the basic idea of the prohibition against corporate interference in internal political affairs and that it was impractical to itemize categories of prohibited activities. However, with regard to paragraph 16, it was suggested that the words "permissible under the laws" be substituted for the words "permitted by the laws", since activities which have not been expressly permitted may nevertheless be permissible because they have not been explicitly prohibited.

3. Respect for national sovereignty

The main issue which arose with respect of the discussion of paragraph 7 of the Chairman's text was whether the provision on permanent sovereignty over natural resources would be unequivocally qualified by a reference to international law. Since the basic approach of the Commission was to stipulate one omnibus provision on international law/obligations (para. 49), a clear linkage between paragraph 7 and paragraph 49 was recognized. The text of paragraph 7 (see below) was considered acceptable if read in conjunction with paragraph 49 on international law and also paragraph 6, which underscores the interrelated nature of all provisions of the code.

Paragraph 7 states:

"Transnational corporations shall respect the national sovereignty of the countries in which they operate and the right of each State to exercise its permanent sovereignty over its natural wealth and resources."

4. Nationalization and compensation

The sovereign right of a State to nationalize or expropriate the assets of a transnational corporation operating in its territory was recognized. It was also recognized that that must be coupled with a duty to pay compensation.

The participants felt that it was not feasible to spell out elaborate and specific principles on the standard of compensation, and that a general and flexible standard would be adequate, particularly in view of the provision on observance of international law/obligations (para. 49).

Accordingly, it was considered that paragraph 57 of the Chairman's text of 1988 was acceptable. That provision reads:

"It is acknowledged that States have the right to nationalize or expropriate the assets of a transnational corporation operating in their territory, and that appropriate compensation is to be paid by the State concerned, in accordance with the applicable legal rules and principles."

It was pointed out that the phrase "applicable legal rules and principles" embraced international as well as municipal legal rules and principles.

The point was made that the assets of a transnational corporation that may be nationalized or expropriated must be in the territory of the nationalizing State. However, that issue had been subject to different judicial decisions in different circumstances and need not be dealt with specifically in the code.

5. Dispute settlement

The basic principles set forth in paragraph 59 of the Chairman's text were found acceptable. Paragraph 59 provides:

"Disputes between States and entities of transnational corporations, which are not amicably settled between the parties, shall be submitted to competent national courts or authorities. Where the parties so agree, or have agreed, such disputes may be referred to other mutually acceptable dispute settlement procedures."

The first part of the provision provoked little comment. As to the second part, there was some concern as to whether the provision for referring disputes to "other mutually acceptable dispute settlement procedures" could not be construed so as to frustrate a prior agreement to submit to arbitration. That was because there was some question as to whether the second sentence of paragraph 49 envisaged two separate steps in the process - namely, an agreement to submit to arbitration and a subsequent agreement on the dispute settlement procedure or mechanism. It was pointed out that no two such steps were envisaged under the provision. It was understood that an agreement to submit to arbitration would cover both of those steps at the same time. Furthermore, the second sentence admitted of a choice of dispute settlement procedure either before or after a dispute arises.

Finally, the term "other dispute settlement procedures" clearly included international arbitration.

6. National treatment

The question was raised as to whether a provision on national treatment (para. 52 of the Chairman's text) was necessary in view of the agreement on paragraph 51 requiring "fair and equitable treatment" for transnational corporations, which is understood to imply non-discriminatory treatment.

However, if paragraph 52 were to be retained, it was suggested that it could be amended to read as follows:

"Subject to national requirements for maintaining public order and protecting national security and consistent with national constitutional law and basic laws, and without prejudice to measures specified in legislation and declared policies relating to the development objectives of developing countries, entities of transnational corporations should be entitled to treatment accorded to domestic enterprises in similar circumstances."

There was considerable debate as to whether it was necessary to provide for the possibility of preferential treatment of foreign investors, as stated in the last sentence of paragraph 52, which reads:

"Nothing in this paragraph should be construed as excluding the right of the host country to grant such special incentives and facilities to transnational corporations as may be considered necessary in its national interest."

The necessity of such a provision was questioned by some participants.